

GROWTH WITH OPPORTUNITY

**A Statement by the Research and Policy Committee
of the Committee for Economic Development**

**PRODUCTIVITY TAXES
DEFICITS INCOME
WELFARE EDUCATION
SPENDING SAVING
SKILLS OPEN MARKETS
POVERTY MOBILITY**

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COMMITTEE FOR ECONOMIC DEVELOPMENT

477 Madison Avenue, New York, N.Y. 10022

(212) 688-2063

2000 L Street, N.W., Suite 700, Washington, D.C. 20036

(202) 296-5860

<http://www.ced.org>

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RESPONSIBILITY FOR CED STATEMENTS ON NATIONAL POLICY

The Committee for Economic Development is an independent research and policy organization of some 250 business leaders and educators. CED is nonprofit, nonpartisan, and nonpolitical. Its purpose is to propose policies that bring about steady economic growth at high employment and reasonably stable prices, increased productivity and living standards, greater and more equal opportunity for every citizen, and an improved quality of life for all.

All CED policy recommendations must have the approval of trustees on the Research and Policy Committee. This Committee is directed under the bylaws, which emphasize that "all research is to be thoroughly objective in character, and the approach in each instance is to be from the standpoint of the general welfare and not from that of any special political or economic group." The Committee is aided by a Research Advisory Board of leading social scientists and by a small permanent professional staff.

The Research and Policy Committee does not attempt to pass judgment on any pending

specific legislative proposals; its purpose is to urge careful consideration of the objectives set forth in this statement and of the best means of accomplishing those objectives.

Each statement is preceded by extensive discussions, meetings, and exchange of memoranda. The research is undertaken by a subcommittee, assisted by advisors chosen for their competence in the field under study.

The full Research and Policy Committee participates in the drafting of recommendations. Likewise, the trustees on the drafting subcommittee vote to approve or disapprove a policy statement, and they share with the Research and Policy Committee the privilege of submitting individual comments for publication.

Except for the members of the Research and Policy Committee and the responsible subcommittee, the recommendations presented herein are not necessarily endorsed by other trustees or by the advisors, contributors, staff members, or others associated with CED.

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PURPOSE OF THIS STATEMENT

This statement is intended to bring together within a common analytic framework a wide array of social and economic issues faced by our nation. The framework, constructed around the objectives of *economic growth* and *economic opportunity*, emphasizes the role of investment in a coherent policy agenda that cuts across issues, agencies, and budgets.

This statement is a comprehensive presentation of principles. We believe that many economic policy issues, despite their complexity in the details, can be clarified by attention to broad analytic principles. Unfortunately, these principles are often neglected in a political environment heavily influenced by special-interest pleading, partisan maneuvering, sound bites, and fragmented debate. We have therefore attempted to “go back to basics” on a group of issues central to the pursuit of economic growth and opportunity, pulling these issues together into a consistent and ambitious policy agenda.

We offer six general recommendations based on CED’s work in policy arenas as diverse as education and international trade.

Each recommendation highlights the most important aspects of that issue. These recommendations are based largely on extensive research detailed in the referenced recent CED statements. The reader is encouraged to consult these statements for more detailed analysis and discussion of these issues.

ACKNOWLEDGMENTS

I would like to thank the members of CED’s Research and Policy Committee (see page v) who helped to craft and guide this study from its inception. We are indebted to the project co-directors: Ronald S. Boster, CED Vice President and Director of Business and Government Policy, Scott A. Morris, CED Economist, and Van Doorn Ooms, CED Senior Vice President and Director of Research. Thanks are also due Anne B. Tramer, Project Research Associate.

Josh S. Weston
Chairman
Research and Policy Committee

INTRODUCTION

PRODUCTIVITY TAXES
DEFICITS INCOME
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For over half a century, CED has advocated business and public policies that would enhance the opportunities for all Americans to improve their lives. Each CED policy report contains a clear statement of these basic goals: *“steady economic growth at high employment and reasonably stable prices, increasing productivity and living standards, and . . . greater and more equal opportunity for every citizen.”*¹

In addressing a broad range of policy issues, CED has argued that economic growth and economic opportunity are usually *complementary*. Without growth, resources will be unavailable to widen opportunity. Without broadly available opportunity, we will fail to fulfill the democratic charge of the nation’s founders and may reduce our potential for economic growth as well.

Several decades ago, Americans felt confident that the prevailing rising economic tide lifted all boats. Strong economic growth during the quarter century after World War II seemed to automatically provide “greater and more equal opportunity for every citizen,” and real incomes grew at a healthy 2-3 percent annual rate for families in all income groups.^{†2} More recently, however, both the strength of the tide and its lift for the smaller boats have diminished. Growth of labor productivity and average real wages slowed sharply after the early 1970s; family income growth slowed less only because of the increase in two-earner families. At the same time, these slowly growing incomes became less evenly distributed, and the proportion of fami-

lies living in poverty increased, as the labor market weakened for workers who lacked advanced education and higher skills.

This conjunction of slower growth with a weaker link between growth and broad economic opportunity is pushing the fruits of growth out of reach of a larger proportion of the population. Public policies designed to broaden opportunity have not taken up the slack. For example, the real value of the Pell grant (the primary higher education grant program for financially needy students) has dropped as the cost of higher education has sky-rocketed during the past 15 years. Some programs, such as Aid to Families with Dependent Children (AFDC), may have done more to promote dependency than to extend opportunity.

We believe it essential that our economic and social policies be directed at *both* growth

[†] The discussions of productivity, real output, and real incomes in this report reflect official measures of inflation. It appears likely that official measures of inflation are overstated, as has been reported by the “Boskin Commission” (see *Toward a More Accurate Measure of the Cost of Living*, Final Report to the Senate Finance Committee from the Advisory Commission to Study the Consumer Price Index, December 4, 1996). This implies that the growth of productivity, real output, and real incomes is correspondingly understated. However, the *slowdown* of productivity, real output, and real income growth since the early 1970s would be overstated only if the upward bias in inflation measures *increased* significantly (and rather abruptly), which is much less certain. Furthermore, an overestimate of inflation is unlikely to have raised the measured increase in *inequality* of wages and incomes. In fact, it may have produced an understatement of such dispersion, since new goods and services and those most subject to mismeasured quality improvements (e.g. computers, health care, cellular telephones) tend to be more important in high-income than in low-income budgets.

and opportunity. We recognize that the two goals may sometimes conflict, but we are convinced that such conflicts can be resolved. The future well-being of American society does not rest in the pursuit of one to the exclusion of the other.*

The *design* of growth and opportunity policies is crucial. For example, if, in the name of “opportunity,” we devise anti-poverty programs that create dependency rather than opportunity, we will fail both to enhance opportunity and to develop human capital conducive to growth. Similarly, if, in the name of “growth,” we pursue tax cuts that raise

budget deficits and reduce national saving and investment, we will reduce both growth and the resources available to extend opportunity.³ We believe that well-designed policies and programs that encourage growth and expand opportunity can be not only complementary, but also mutually reinforcing (see “Poverty as an Opportunity Lost,” below). Ultimately, growth is necessary to provide the new avenues for personal advancement and resources to expand opportunities, and the expansion of opportunities to all Americans, in turn, will raise the economic capacity of our society.

POVERTY AS AN OPPORTUNITY LOST

A recent research project chaired by the Nobel laureate economist Robert Solow used an “unproductive resources” approach to assess the cost of poverty in the United States.^a The research team used four different methodologies to estimate the lost economic output related to childhood poverty. All four used the shortfall in future earnings of poor children as an estimate of the reduction in their contribution to economic output. When calculating earnings losses on the basis of *educational attainment alone*, researchers estimated a loss in future economic output of

\$36-98 *billion* each year, so long as current levels of poverty continue.

The study’s most comprehensive estimate, which included the additional costs of other poverty-related factors such as unemployment, lower skill-attainment abilities, and higher incidences of poor health, was much higher — \$177 *billion*, or about three percent of gross domestic product (GDP), annually.

(a) Arloc Sherman, *Wasting America’s Future: The Children’s Defense Fund Report on the Costs of Child Poverty*, (Boston) Beacon Press, 1994.

*See memorandum by JAMES Q. RIORDAN, (page 38).

ECONOMIC GROWTH

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THE GROWTH RECORD

The United States experienced a period of extraordinary economic growth in the quarter century following World War II. From 1947 to 1973, real domestic output increased at an average annual rate of 4 percent, raising per capita output by two-thirds.

By all accounts, most American families became better off during these so-called “golden years.” Real family incomes more than doubled between 1947 and 1973. At the same time, families were becoming smaller, so that the average family spread its income among fewer members in 1973 than in 1947.[†]

Not only did the “average” citizen become substantially better off during this period, but real incomes rose dramatically for those at the lower end of the income distribution. Between 1949 and 1969, the proportion of Americans living in poverty fell from 40 percent to 14 percent.⁴

Other measures of well-being also reflected this rapid progress. For example, average life expectancy rose from 68 years in 1950 to 72 years only a quarter century later.⁵ Over the 30-year period from 1940 to 1970, home ownership increased from 44 to 63 percent of all households and access to indoor plumbing

rose from 55 to 93 percent.⁶ These are just a few indicators of what came to be known as the “American dream,” a term that entered the nation’s lexicon during the dynamic post-war years.

But the vigorous national and family income growth that characterized this period faltered in the early 1970s, when the growth of labor productivity dropped sharply. Figure 1, page 4, shows the difference in income growth between the two periods. A careful look at the impact of this productivity slowdown on economic growth and workers’ compensation helps to explain the changes of the last two decades.

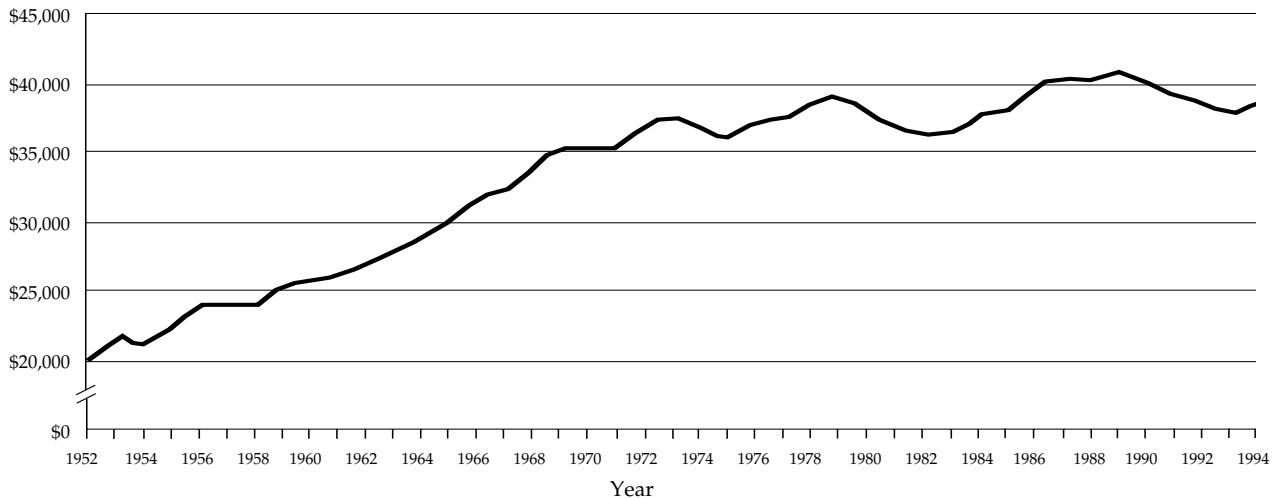
PRODUCTIVITY: THE ENGINE OF ECONOMIC GROWTH

Productivity, or output produced per unit of input, is the primary characteristic of economic growth and the ultimate determinant of per capita incomes and living standards (see “Sources of Growth — More Hours Versus More Output per Hour,” page 7). The most commonly used measure of productivity is labor productivity, or output per hour of work, both because it is most closely associated with living standards and because it is the measure for which the richest data are available. In spite of short-term fluctuations in the share of national income received by labor, the relationship between productivity growth and real worker compensation has been strong and remarkably stable over time,⁷ so that the rapid productivity improvements during the “golden years” translated into large gains in workers’ earnings and compensation.

[†] In fact, adjustments for the change in family size during 1967-1973 suggest that size-adjusted average family income grew about 25 percent faster than the unadjusted measure. See U.S. House of Representatives, Committee on Ways and Means, *1994 Green Book*, (Washington, D.C.: U.S. Government Printing Office, 1994), P. 1186.

Figure 1

The Slowdown in Family Income Growth^(a)



(a) Median family income in 1994, CPI-U-X1 dollars.

SOURCE: U.S. Department of Commerce, Bureau of the Census.

As Figure 2, page 6, shows, productivity grew on average by 2.9 percent per year from 1959 (the earliest year for which comparable data are available) to 1973, well above its long-term trend of just over 2 percent. The productivity record after 1973 was dismal by comparison; from 1973 to 1995, productivity growth averaged little more than 1 percent, a decline of nearly two-thirds from the earlier period, and half its long-term trend.

The reasons for the apparent productivity slowdown are not fully understood. A small portion of it can be attributed to a reduction in the growth of capital employed per worker and to increased regulatory burdens. However none of it can be traced statistically to slower improvements in the education and experience of the work force or reduced investments in research and development. It is likely that overestimated inflation and other measurement problems, particularly in the increasingly important services sector, have led to underestimated growth in output and productivity, but it is uncertain whether these problems have become more severe over time.^{8†}

RECOMMENDATIONS TO RAISE ECONOMIC GROWTH

Our inability to explain fully why productivity growth collapsed does not mean we are powerless to raise it. We know as a matter of research, observation, and common sense that the productivity of the work force is related to its motivation, education, training, and skills, to the amount of capital with which it works, and to the rate of improvement and effective application of new technology. Cost-effective improvements in these areas point the way to stronger growth.

Policies to increase the productivity of the work force and thereby raise economic growth

[†] As noted in the footnote on page 1, overestimates of inflation probably reduced measured productivity growth, but only increasingly severe overestimates would produce a *slowdown* in productivity growth. While increasing measurement is quite plausible, there is little evidence to demonstrate it, much less to indicate its magnitude over the last several decades. The Boskin Commission report discusses individual cases that imply both increasing and decreasing measurement error.

fall into three broad categories. These policies should:

- increase the private capital stock through higher national saving;
- shift public spending away from consumption and toward productive investment;
- encourage more open and efficient markets at home and abroad.

In each of these areas, public policies can enhance or retard economic growth. Unfortunately, much of the current popular discussion of economic growth inappropriately overlooks the fundamental determinants of growth. For example, there has been undue emphasis on expansionary monetary policy, which is unlikely to affect long-term growth (see “Monetary Policy: What It Can and Cannot Do,” page 8). Similarly, while reductions in marginal tax rates may have some positive effect on growth, they are almost certainly less effective than deficit reduction (see following section).⁹

RECOMMENDATION 1

DEFICITS AND NATIONAL SAVING[†]

To increase private capital formation, we should raise net national (i.e., private and public) saving to its pre-1980 average of roughly 10 percent of net national product. This would require a modest structural (or “high-employment”)^{††} federal budget surplus. Timely action is imperative; because of the huge projected increase in long-term budget deficits, delay will make adjustment more painful and politically more difficult.

Productivity ultimately depends on investments in capital, broadly defined: physical capital, human capital, and the expansion of knowledge through research. Investment in physical capital — business plant, equipment,

and public infrastructure^{†††} — is the subcomponent that we can most readily measure. Generally, the more physical capital workers have to support them, the more productive they will be. U.S. workers have had more capital to work with than have workers in other countries, which partly explains the higher levels of productivity in the United States.

In addition to *increasing* the capital stock, new plant and equipment often embody new technology and thereby improve the *quality* of capital. Replacement and upgrading of machines, structures, and transportation and communications systems ultimately produce major productivity improvements. It has been estimated that as much as 80 percent of the technical progress contributing to U.S. economic growth is embodied in new investment. If the productivity improvements resulting from “embodied technical progress” are attributed to the capital that contains it, new investment can be said to account for roughly three-quarters of increases in labor productivity.¹⁰

Net domestic investment has fallen by roughly half over the past three decades, from about 10 percent of net national product in the 1960s and 1970s to about 5 1/2 percent in the 1990s, although in 1994-1995 it rose to 7 per-

[†] See the following CED statements: *Restoring Prosperity: Budget Choices for Economic Growth* (1992), *Cut Spending First: Tax Cuts Should Be Deferred to Ensure a Balanced Budget* (1995).

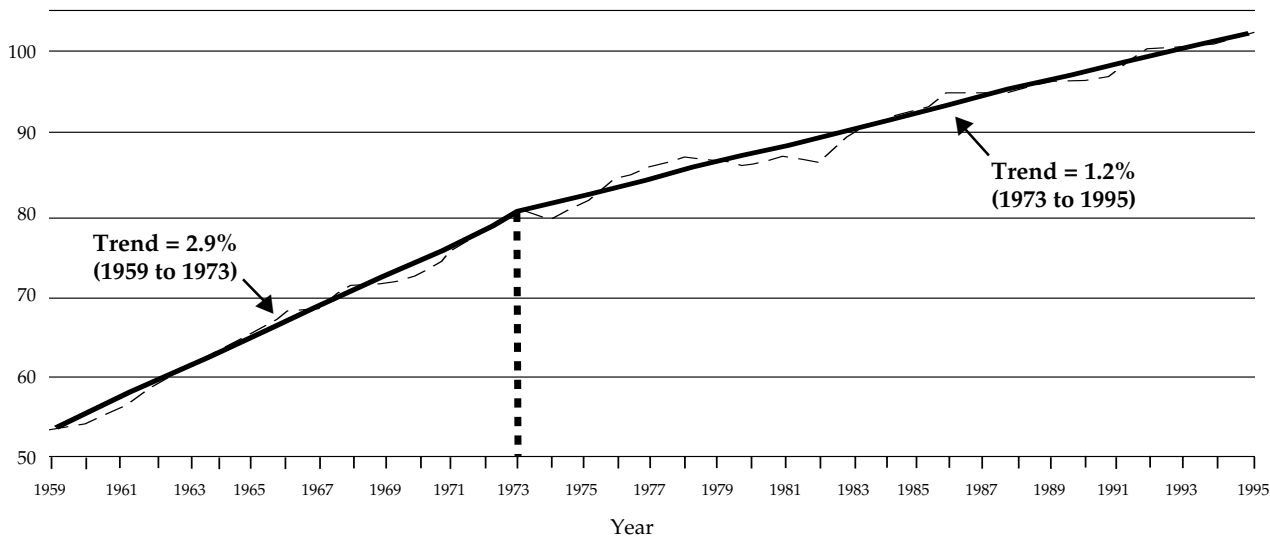
^{††} In contrast to the actual deficit, a “structural” or “high employment” budget deficit is the deficit that would occur under current policies if the economy were operating at its full potential. As CED has argued in fiscal policy statements for over 40 years, structural rather than actual surplus is the appropriate policy goal because it would allow for actual deficits (or smaller surpluses) during recessions in order to boost economic activity.

^{†††} As part of a broad revision of the National Income Accounts in 1996, the U.S. Department of Commerce now classifies additions to the public capital stock as investments rather than consumption. Before this revision, official estimates consistently understated national investment and saving by excluding an important component of investment. As a result of this change, estimates of national investment and saving are higher than in previous CED reports.

Figure 2

The Productivity Slowdown^(a)

Index, 1992=100 (ratio scale)



(a) Output per hour of all persons, non-farm business sector.

SOURCE: U.S. Department of Labor, Bureau of Labor Statistics.

cent (see Figure 4, page 9).[†] Lower national saving, the sum of private saving and government saving (or dissaving in the case of budget deficits) has largely determined the diminished resources available for investment (see "Saving at Home or Borrowing from Abroad," page 10). Net national saving has fallen even more dramatically than investment, from a pre-1980 average of 11 percent of net national product to 4 percent in the 1990s.

The decline in national saving reflects declines in both private and public saving. Private households have increasingly shifted income from saving to additional consump-

tion (see Figure 5, page 9); recent private consumption rates have rivaled those of the period immediately following World War II, when pent-up demand from the war years led to an unprecedented post-war consumption boom.

The impact of declining personal saving on the national saving rate has been compounded by federal budget deficits, which constitute public dissaving. Federal deficits currently absorb about one-third of private saving, crowding out private investment by raising real interest rates. Figure 7, page 11, shows that in the years before 1980, net saving by all levels of government was positive on average, which added to national saving. After 1980, however, the government sector moved into the red, which reduced national saving. If government saving had been zero during the first half of the 1990s, the national saving rate would have been about 50 percent higher — nearly 6 percent of net national product instead of 4 percent.

[†] "Net investment" and "net national product" are net of "capital consumption," a charge in the National Income Accounts for the scrapping and obsolescence of fixed capital. Net rather than gross investment is used here because it better describes the quantitative increase in the capital stock that contributes to future output growth. However, these "net" measures do not capture the higher productivity of new capital or that resulting from upgrading and improvement of existing capital; productivity increases resulting from such technological improvements are captured in measures of "technical progress."

While we should endeavor to raise both public and private saving, the most certain and effective policy to increase *national saving* is to eliminate the government dissaving

resulting from federal budget deficits. With this in mind, we welcomed the public commitments of Congress and the President in 1995 and 1996 to the goal of a balanced federal

SOURCES OF GROWTH—MORE HOURS VERSUS MORE OUTPUT PER HOUR

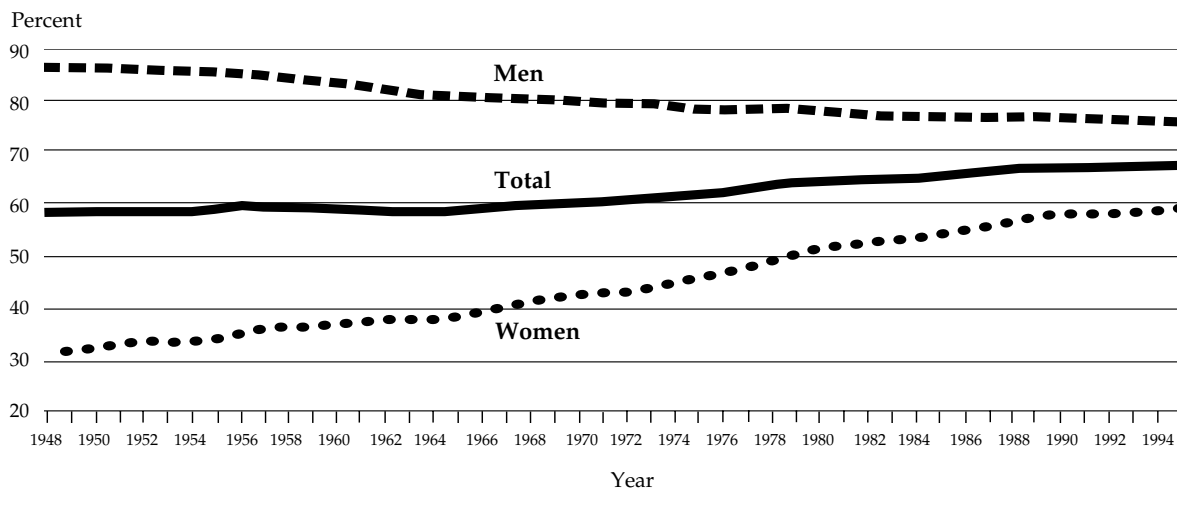
Changes in hours worked and in output-per-hour worked (productivity) by definition account for economic growth. Both have contributed significantly to growth in the U.S. economy since World War II, but it is the latter that largely accounts for Americans being “better off.” Increases in rates of labor-force participation (or in the average work-week) are not as unambiguously associated with improvements in “well-being” as are increases in productivity. A family that doubles its income by doubling the number of hours spent at work is generally not as well off as it would be if its income had doubled through higher wages. It is through improvements in productivity that higher wages are possible.

An increase in hours worked through higher rates of labor-force participation has been a significant source of economic growth over the past 50 years, and particularly in the past 20 years, when it accounted for over half of economic growth.

This trend is reflected in an increase in the number of earners per family: the ratio of multiple-earner to one-earner households has increased steadily in recent years. This increase typically has meant more female family members going to work. But as Figure 3 shows, the growth in female labor-force participation has flattened during the 1990’s, and overall labor-force participation, with that of men continuing to decline, has leveled off as a consequence.

Figure 3

Labor Force Participation Rates



NOTE: Data refer to persons 16 years and over. Pre-1994 participation rates are corrected for effects of the revised Current Population Survey questionnaire.

SOURCE: U.S. Department of Labor and Council of Economic Advisers.

budget by 2002. At no time in the past 20 years had the climate been as favorable for elimination of the deficits that have plagued our national governance. *The failure to enact measures*

that would achieve this goal indicates a failure of political leadership. The budget plans and negotiating strategies of both the President and Congress served more to harden partisan

MONETARY POLICY: WHAT IT CAN AND CANNOT DO

Continuing low inflation during the current economic expansion and a belief that current price measures overstate inflation have led some to argue that faster economic growth without higher inflation is possible through a more expansionary monetary policy. The requirements for faster long-term growth of output are unambiguous: *The economy cannot grow faster than the sum of increases in hours worked by the labor force and labor-force productivity.* Unfortunately, this basic principle is often ignored in arguments for monetary expansion.

Such arguments frequently confuse an increase in the long-term, sustainable *rate of growth* (the growth rate of “potential output”) with a short-term increase in output to its full capacity or potential *level*. In doing so, these arguments also display a misunderstanding of the economic effects of monetary expansion.

A higher sustainable growth rate (which would indeed produce large economic benefits) is achievable only through faster growth of labor inputs, higher rates of investment, or more rapid technical progress, including gains in managerial organization and efficiency. *We can and should adopt policies that raise such “supply-side” determinants of long-term growth, but they cannot be raised by monetary expansion.* Monetary expansion raises *demand* and, consequently, could raise the *level* of output and employment on a one-time basis, if there were significant unemployed capacity. Such a “demand-side” boost would raise output growth, briefly and temporarily, until full capacity was reached. But it would not raise the *sustainable* growth rate, and it would raise inflation if maintained after the slack in the economy had been eliminated.

Some advocates of a looser monetary policy argue that the information revolution, more efficient production processes, a more open

economy, and “underemployment” of individuals outside the measured labor force imply a level of potential output and/or a sustainable growth rate higher than that accommodated by the Federal Reserve Board. However, the experience of 1994-1996, when the economy was growing at its potential of 2 to 2 1/2 percent annually, does not support this view. If the economy had been operating significantly below its potential during this period, the unemployment rate would have risen and wage inflation fallen. Neither, in fact, occurred.

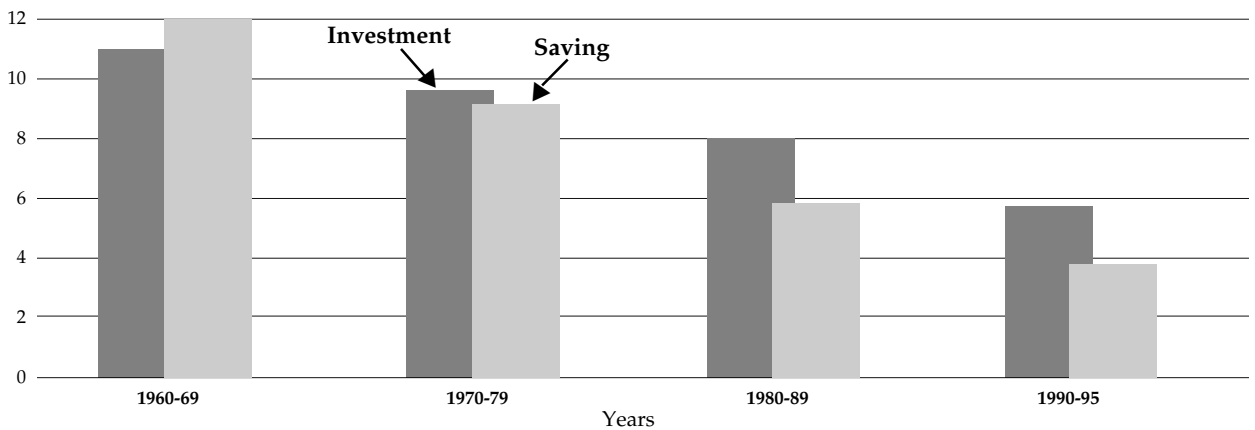
A final argument sometimes made is that the widely recognized overstatement of inflation by official measures offers a rationale for monetary expansion. Lower inflation, it is suggested, provides the Fed more leeway to allow faster growth. This argument, however, is clearly wrong. If inflation is overstated, then economic growth (the estimate of which depends on the inflation estimate) must be understated, and we are already “growing faster.” Still faster growth would require an increase in the supply factors, which could not be provided by monetary expansion, for the reasons noted above.

Recent monetary policy has been highly successful, by historical standards, in sustaining economic growth with low inflation. This recent success should not be placed lightly at risk. We should not forget the economic distortions produced by the high inflation of the 1970s and the heavy costs of the severe recession required to end it. We agree that the monetary authorities should cautiously explore the possibility that changes in the economy have raised the level of economic activity compatible with low inflation. Recent Federal Reserve policy suggests to us that this is, in fact, what the Fed has been doing.

Figure 4

The Decline in Investment and Saving^(a)

Percent



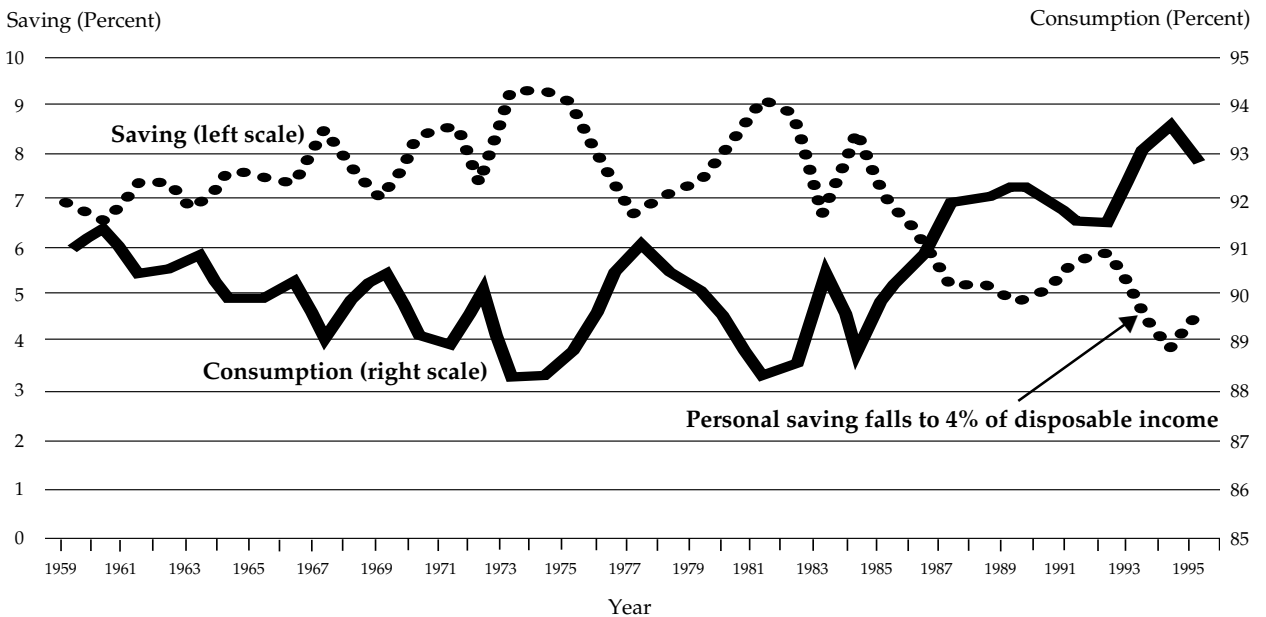
(a) Net national investment and net national saving as a percentage of net national product.

SOURCE: U.S. Department of Commerce, Bureau of Economic Analysis.

Figure 5

The Fall of Saving and the Rise of Consumption

Personal Saving and Consumption as a Percent of Disposable Income



SOURCE: U.S. Department of Commerce, Bureau of Economic Analysis.

positions than to foster compromise and eventual agreement.*

Major shortcomings of both budget plans, but especially that of the Congress, were the

proposals for large tax cuts, which would likely raise deficits and reduce national saving. As CED argued in June 1995, “**net reductions in revenues before a balanced budget is assured**

SAVING AT HOME OR BORROWING FROM ABROAD

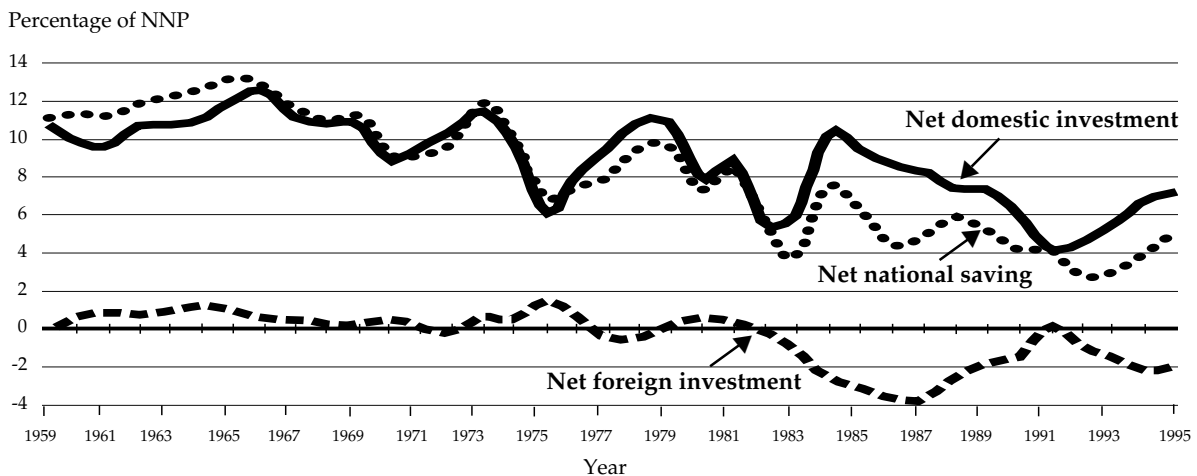
Resources for national investment must come either from saving at home or from borrowing from abroad. An increase in foreign borrowing is necessarily reflected in a country's balance of trade. Figure 6 shows this relationship for the U.S. economy over the past 35 years. From 1959 to 1981, when national saving outpaced domestic investment, the U.S. net foreign investment position — determined principally by the balance of exports and imports — was usually positive. Since then, as national saving has fallen below domestic investment, net foreign investment has been necessarily negative.

The trade deficit has consistently received attention as an important source of America's economic woes in recent years. Yet, almost none of this attention has focused on the *funda-*

mental cause of the trade deficit — our low national saving. The “economic problem” represented by the trade deficit is principally a deficiency of domestic saving, which reduces domestic resources available for investment and forces us instead to import resources from abroad. By relying on resources from abroad rather than domestic saving, the United States is borrowing against future income, requiring payments of interest and dividends to foreign lenders. The more persistent foreign borrowing becomes, the worse our terms of borrowing are likely to be; higher interest rates may be required to induce foreigners to hold still more U.S. assets, increasing further the future flow of domestic resources abroad, and reducing incomes in the United States.

Figure 6

Saving, Investment, and the Trade Balance^(a)



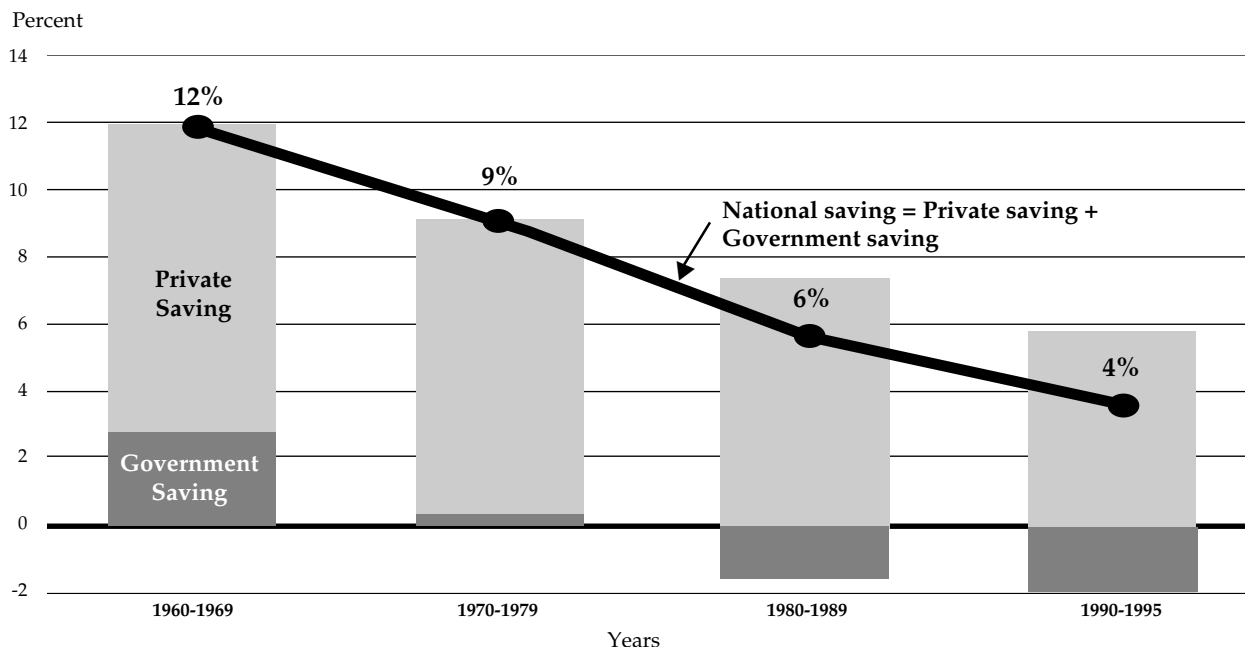
(a) Net domestic investment, net national saving, and net foreign investment are expressed as a percentage of net national product. Net foreign investment includes the trade balance and the balance on investment income and transfers.

SOURCE: U.S. Department of Commerce, Bureau of Economic Analysis.

*See memorandum by JAMES Q. RIORDAN, (page 38).

Figure 7

Both Public and Private Saving^(a) Have Declined



(a) Net national saving, net private saving, and net government saving as a percentage of net national product. Net government saving includes federal, state, and local government.

SOURCE: U.S. Department of Commerce, Bureau of Economic Analysis.

would be a grave mistake.”¹¹ The tax cut proposals contributed to the impasse in the overall budget negotiations, producing a fruitless and acrimonious debate about who should benefit from a tax cut and which spending cuts have “paid for” it — exactly the outcome we warned against when tax cuts were first proposed.^{12 *}

Because the basic requirement for stronger economic growth is higher *national* saving, not higher *private* saving per se, our support for tax incentives to increase private saving is qualified. After much public and academic debate, the evidence that tax-based saving incentives such as liberalized Individual Retirement Accounts and Family Saving Accounts would, in themselves, raise the rate of *national* saving is mixed at best.¹³

A tax-based saving incentive will only increase national saving if the net effect of the

resulting changes in private *and* public saving is positive. This requires that any revenue loss to the U.S. Treasury (a reduction in *public* saving) be more than offset by an increase in private saving. This is a difficult test to pass. A tax-based saving incentive that is fully financed by cutting spending (or raising other revenues) is likely to increase national saving. Even so, the increase in national saving would almost certainly be larger if spending cuts were devoted to deficit reduction rather than to financing tax reductions.¹⁴ Consequently, we believe the House Budget Committee Republican staff was correct when it concluded in 1991 that “*there is no tax incentive that promotes growth as effectively as deficit reduction*” [emphasis in the original].¹⁵

At the same time, the current tax code often favors consumption over investment, with similar costs in lower productivity

*See memorandum by EDMUND B. FITZGERALD, (page 38).

growth. For example, the exclusion from taxable income of employer-provided health insurance raises consumption of health care. Similarly, the mortgage interest deduction for owner-occupied housing shifts investment resources to housing “at the expense of other investments which directly enhance productivity.”¹⁶ **Our tax laws should be modified to eliminate the current bias towards consumption and against productivity-enhancing investments.**

In 1997, our political leadership should keep in mind the experience of the past two years in budget negotiations. This time, they should put aside talk of tax cuts and complete the business of balancing the budget.

THE LONG-TERM BUDGET OUTLOOK

Although the budget deficit has fallen recently, both in absolute value and as a percentage of GDP, the long-term budget outlook is truly alarming, primarily because of entitlement trends. As a result, CED’s long-standing concern about deficits and their adverse impact on economic growth and opportunity takes on a new urgency.

Recent simulations by the nonpartisan Congressional Budget Office (CBO) and others show clearly the unsustainability of the current fiscal path. CBO projects that, under current policies, the federal budget deficit would increase from 2 percent to 37 percent of GDP, and the national debt would jump from 51 percent to 293 percent of GDP in 35 years. The crowding out of growth-enhancing investment by these fiscal burdens implies that per-capita output would begin to *fall* within 25 years.¹⁷

There are two principal reasons for this impending explosion of the budget deficit and public debt. First, the aging and retirement of the Baby Boomers will require much higher outlays for Social Security, and especially for Medicare and Medicaid. Second, the rising relative cost of health care will further increase Medicare and Medicaid costs. These problems

are fundamental and relatively intractable. According to CBO, our fiscal path remains unsustainable “even under optimistic assumptions, including favorable demographic trends and historically high rates of productivity growth.”¹⁸ This conclusion is buttressed by similar independent analyses done by the General Accounting Office (GAO) and the Office of Management and Budget (OMB).¹⁹

The unsustainability of current fiscal policies is confirmed by an analysis of “generational accounting,” which addresses the question: *What taxes on the lifetime incomes of Americans yet unborn would be required to pay for currently projected federal expenditures?*²⁰ While answers to this question are quite sensitive to the assumptions made, one recent estimate suggests that net tax rates would more than double, rising to an estimated 85 percent from the current estimate of 34 percent for the cohort born between 1960 and 1993.²¹

Such projections are not forecasts of what *will* happen, since the adverse economic effects of such rapid debt accumulation presumably would force painful policy changes long before these outcomes were reached. Nevertheless, these analytic exercises dramatize the size of the problem as well as the urgent need for timely action. The longer the inevitable policy changes are delayed, the larger, more abrupt, and more painful they will be. Moreover, the political difficulty of change will increase as the elderly grow as a proportion of the electorate.

We urge the political leadership, particularly the Administration, to acknowledge the necessity of major reforms in Medicare, especially those features of the program related to cost sharing. Until the long-term fiscal integrity of Medicare, and, indeed, Social Security are restored, there will be no chance of long-term budgetary balance.²² We fully appreciate the political difficulty of programmatic reforms. But such changes cannot be avoided for long, and it is the responsibility of our political leadership to address them.

RECOMMENDATION 2

BUDGET PRIORITIES[†]

The federal government should adopt an investment-oriented federal budget and an investment-oriented deficit reduction program that will build capital (human and technological, as well as physical) and enhance productivity growth. The first step is to reform the nation's unsustainable entitlement programs.

Just as deficits have crowded out private investment in the capital stock, public consumption expenditures have crowded out investments *within* the federal budget. Investments in physical capital, research and development (R&D), and human capital have been a declining portion of the federal budget, falling from about 32 percent of total federal outlays in the early 1960s to about 16 percent today (see Figure 8). These investments have also fallen significantly relative to GDP, from about 6.2 percent in the early 1960s to just over 3 percent today.²³

Both R&D and human capital investments contribute to technical progress, which may account for more than half of U.S. productivity growth.²⁴ Technical progress is a broad measure of society's increased capacity to use physical resources. It captures improvements from R&D (through new products and production processes), from human capital (through more skilled workers and more efficient work arrangements), and from other improvements in production processes that are not readily measured (such as "learning by doing").

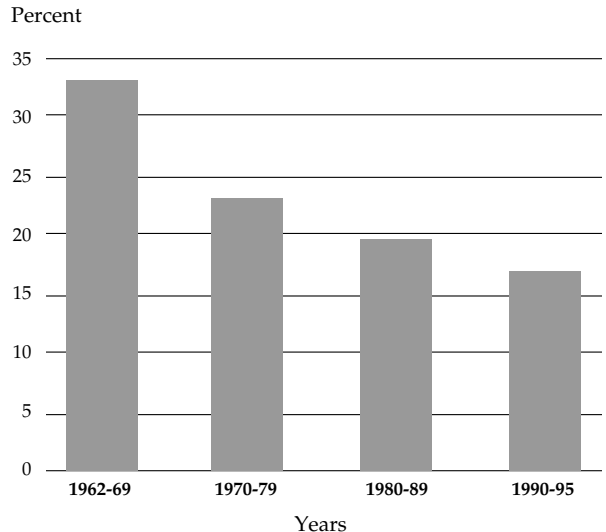
Financing R&D has long been both a private *and* public undertaking in the United States. While private investment in R&D has

[†]See the following CED statements: *Investing in America's Future: Challenges and Opportunities for Public Sector Economic Policies* (1988), *Restoring Prosperity: Budget Choices for Economic Growth* (1992). See also *Fixing Social Security* (1997).

Figure 8

The Crowding Out of Federal Investment:^(a)

Investment as a Percentage of Total Federal Outlays, 1962-1995



(a) Federal investment is defined by the Office of Management and Budget as outlays for physical capital, research and development, and education and training.

SOURCE: Budget of the United States Government, Historical Tables, Fiscal Year 1997.

surpassed public levels over the past two decades, both public and private spending have declined relative to total output during the 1990s. Improvements in human resources, through education and training, are necessary not only to keep pace with and thereby apply technical advances, but also to expand the economic capacities of less-skilled members of society. Although difficult to measure, increases in the formal educational attainment of the work force alone have been estimated to account for roughly 20 percent of productivity increases in the last several decades.²⁵ Likewise, there appears to be a strong relationship between labor force quality (measured by cognitive skills in mathematics and science) and economic growth.²⁶

The budgetary crowding out of public investments since the 1970s is related closely to the explosive growth in entitlement spending. Most entitlement programs are transfers of income from taxpayers to beneficiaries — usually from younger taxpayers to older recipients — that provide little in the way of *future* returns and may entail significant efficiency losses in the economy. Neither party's political leadership has been willing to address the looming insolvency of Social Security and recent efforts (by Congress more than the Administration) to scale back growth in Medicare spending have been unsuccessful.

The shift in budgetary priorities is clear: while investment has fallen from 32 percent of the federal budget in 1962 to 16 percent in 1995, entitlement spending has grown from 20 percent to 48 percent. The budget proposals by both the Congress and the Administration in 1995 would have continued this expansion of entitlement spending at the expense of investment and other discretionary spending. For example, in order to reach balance by the year 2002, both plans would have placed "caps" on discretionary spending that imply reductions in R&D investment of as much as one-third of current levels.

In the process of eliminating deficits, U.S. policy makers should establish budget spending priorities that give larger weight to future returns. Productive economic activity depends upon private *and* public investment. We recognize that labeling public spending as "investment" does not make it so, and that many so-called public "investment" activities would fail market tests of usefulness, efficiency, and competitive returns. Nevertheless, *effectively chosen and designed* public invest-

ments in physical capital, R&D, and human capital (such as education and training) are essential to economic growth, as they have been throughout our history.

About one-third of total budget spending is discretionary (approximately half of which is for national defense) and two-thirds is entitlement spending (including interest on the debt). Investment programs are found principally in the "discretionary" portion of the federal budget and are generally funded through annual appropriation laws. Entitlement programs, on the other hand, are funded automatically according to statutory formulas. Discretionary programs are politically less difficult to cut than entitlement programs, which provide benefits to millions of (principally elderly) voters. Consequently, discretionary spending has borne the brunt of recent deficit-reduction efforts. Further, annual piecemeal cuts in the discretionary budget make long-term investment programs particularly difficult to plan and implement successfully.

The disappointing budget outcomes for fiscal years 1996 and 1997 dramatically illustrate this problem. The limited agreements between the President and Congress made most of the spending cuts in discretionary (often investment) programs. Both the President and Congress assume large additional reductions from this shrinking group of discretionary programs in future years in order to project a balanced budget. Most experienced budget observers believe that discretionary cuts of this magnitude would be highly disruptive in many programs and are therefore unlikely to happen. This further underscores the importance of restraining the growth of entitlement programs.

RECOMMENDATION 3

OPEN AND EFFICIENT MARKETS[†]

More open and efficient markets (at home and abroad) can raise productivity and growth. Regulations imposed without due attention to costs and impediments to international trade and investment create significant barriers to achieving our full productive potential as a nation. Therefore:

- To reduce the economic costs of regulations and maximize their effectiveness, regulatory regimes should be developed in the context of cost-benefit and risk analyses and should favor flexible, market-based mechanisms over rigid, command-and-control structures;
- The United States should continue to lead global efforts to open markets for goods, services, and capital.

REGULATION

Regulation in many fields — including the environment, health, and safety — is necessary in our complex society. The benefits of regulation are both commonplace and dramatic, from standards that ensure food safety to burgeoning recreation on cleaner, healthier waterways.

There is growing evidence and awareness, however, that regulation often fails to achieve its goals or does so inefficiently at unnecessarily high costs. Furthermore, it sometimes has the effect of protecting vested interests more than consumers. Aggregate regulatory compliance costs to the private sector for federal regulations are currently on the order of

\$670 billion annually, or about one-tenth of GDP.²⁷ The growing regulatory burden during the 1960s and 1970s is estimated to account for 13 to 30 percent of the productivity (and wage) slowdown during the 1970s.²⁸

Regrettably, calls for regulatory reform are often portrayed as “anti-regulation.” This generally wrong-headed characterization confuses regulatory *goals* with the means of *achieving* them. We do not oppose most regulatory goals. Our long-standing advocacy of regulatory reform is rooted rather in a search for *efficiency* — in the conviction that environmental and other goals often can be reached at smaller costs of necessarily scarce resources.

All regulations involve tradeoffs between the benefits they provide and the costs of achieving them. Cost-benefit and risk analyses, whether formal or informal, are useful in assessing these inevitable tradeoffs. These analytic tools are not definitive, but they should not be viewed as roadblocks in the regulatory process. On the contrary, by detailing the effects and costs of a proposed regulation, cost-benefit and risk analyses can guide regulators toward less costly designs and more effective implementation strategies.

Principles of cost-benefit and risk analysis are important at all stages of the regulatory process. Too often, regulatory agencies — at the federal, state, and local levels — lack the flexibility to use proper cost-benefit or other analyses due to narrow guidelines written into regulatory statutes. **Lawmakers should provide regulators with wider discretion to determine the most effective means of achieving regulatory goals. At the same time, this wider discretion will only be effective if regulators themselves pay close attention to efficiency principles as they exercise discretion in implementing regulations.**

As problems that require regulation become increasingly complex, rules that are rigid, centralized, and uniform are unlikely to be successful and almost certain to be inefficient. Market-based mechanisms — such as emission taxes and tradable pollution permits

[†] See the following CED statements: *What Price Clean Air: A Market Approach to Energy and Environmental Policy* (1993), *Redefining Government's Role in the Market System* (1979), *Investing in America's Future: Challenges and Opportunities for Public Sector Economic Policies* (1988), *The United States in the New Global Economy: A Rallyer of Nations* (1992), *U.S. Trade Policy Beyond the Uruguay Round* (1994), *In Our Best Interest: NAFTA and the New Economy* (1994).

— are generally preferable to traditional command-and-control regulatory approaches. **It often will be far more effective and less costly to define *broad goals*, rather than technically specified results, and then to design regulations that rely more on market-determined incentives and behavior to achieve these goals.**²⁹

INTERNATIONAL TRADE AND INVESTMENT

U.S. economic progress has increasingly relied upon a dynamic global economy, to the alarm of some but the benefit of most. The United States and a growing number of its trading partners have worked steadily over a half-century to create more open markets for trade and investment. The increasing impact of international markets is reflected in the dramatic growth of U.S. exports and imports in recent years, both in absolute terms and in relation to our total economic output (see Figure 9).

The United States is the world's largest importer and exporter of goods and services; trade (the value of exports plus imports) has risen from 9 percent of GDP in 1960 to about 22 percent today. Export growth in the last several years has accounted for roughly one-third of U.S. economic growth.

Trade and global expansion contribute to U.S. prosperity in several ways. First, international competition forces U.S. firms to be more efficient in order to remain competitive. Second, both imports and more efficient domestic firms give U.S. consumers greater choice and lower prices. Finally, larger foreign markets create greater opportunities for the U.S. export sector, where jobs pay 13 percent more than the national average.³¹

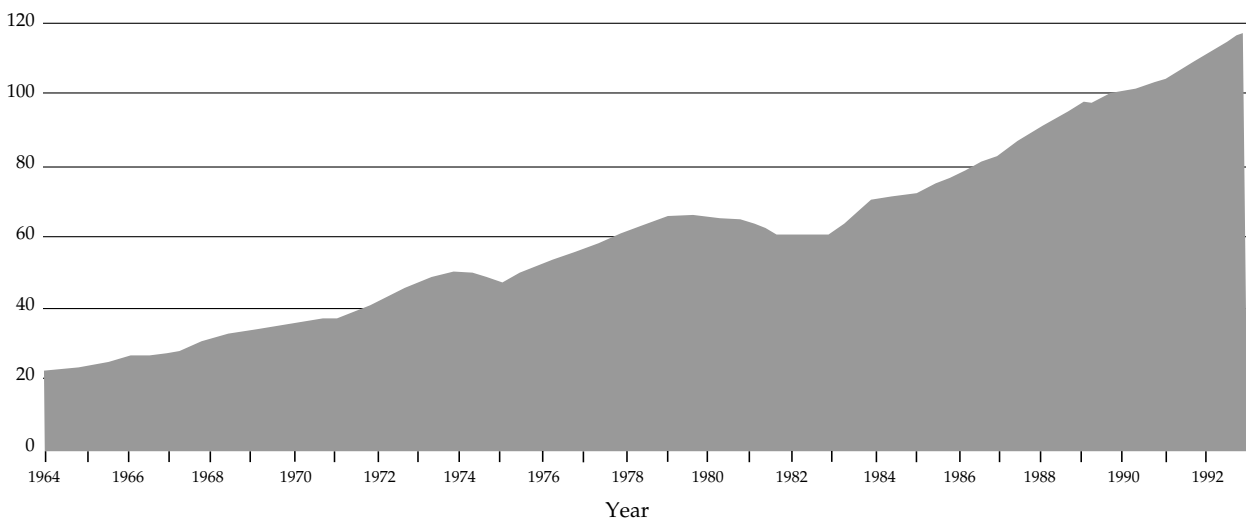
Protectionist and isolationist critics of international economic integration blame foreign trade and investment for domestic unemployment and slow aggregate income growth. We find these claims to be largely

Figure 9

The Rapid Growth of Trade

Volume of U.S. Exports + Imports, 1964-1993

Index, 1990=100



SOURCE: *International Financial Statistics Yearbook*, International Monetary Fund, 1995.

uninformed and ill-founded. *Trade affects the quality of jobs, not total employment levels; as imports “destroy” low-productivity jobs, exports replace them with higher-productivity and higher-wage jobs.* The impact of trade on overall output and incomes is positive. As we have noted, America’s trade deficit and inadequate growth largely reflect self-inflicted wounds related to low national saving.

This critique, however, does illuminate one very important issue regarding economic opportunity. Trade with low-income countries and immigration into the United States probably *have* contributed to the reduced demand for *less-skilled* American workers. As America’s comparative advantage in production and trade shifts further towards goods and services that require new technology and more-skilled workers, less-skilled workers lose their jobs as lower-productivity industries decline. The new, higher-wage jobs created by trade go to those who have the skills to take advantage of them. It is therefore essential that we increase and broaden skill development in our present and future labor force, thereby fostering both growth and opportunity.

Vigorous global economic development will require continuing commitments from all countries to open their markets for goods, services, and capital. Through enactment of the North American Free Trade Agreement (NAFTA) and the Uruguay Round General Agreement on Tariffs and Trade (GATT) legislation and leadership and support for the new World Trade Organization (WTO), the United States has demonstrated a strong commitment to further liberalization of the global economy. **We therefore urge the Congress to extend “fast track” authority to the President, the lack of which stands in the way of future U.S. leadership in multi-lateral trade negotiations.**

The United States’ advocacy of open markets abroad is further impaired by constrained

markets at home. **We should therefore promote better jobs and higher incomes by reducing our own barriers to trade and investment, while simultaneously we aggressively pursue open markets abroad.**

We recognize that in some instances our market access is effectively limited by the actions of private firms or by public policies beyond the purview of the WTO dispute-resolution mechanism. In such cases, direct bilateral discussions and actions may be appropriate. Nevertheless, in pursuing more open foreign markets, the United States should generally resist political pressures for bilateral confrontation and unilateral action. Unilaterally imposed sanctions, for example, have been largely ineffective in achieving their goals in the past and have imposed economic costs on the sanctioning country. In most instances, trade disputes will be more effectively resolved through the dispute settlement facilities of the WTO. The United States has an enormous stake in the success of the WTO, and its decisions should be respected.

American workers and consumers have benefited significantly from foreign investments here. Foreign firms recognize the quality of the U.S. work force and economic environment and have responded by establishing U.S. facilities that export as well as serve the domestic U.S. market. For example, in recent years, Honda has been exporting cars it makes in Ohio to other countries, including Japan. **This foreign presence is healthy, and we reaffirm our support for the *national treatment*[†] of foreign companies operating in the United States, recognizing that it is incumbent on these companies to pay their fair share of American taxes.**

[†] National treatment is the principle that foreign investors, once established in a country, should be treated no less favorably than domestic enterprises with respect to national laws, regulations, and administrative practices.

ECONOMIC OPPORTUNITY

PRODUCTIVITY TAXES
DEFICIT INCOME
WELFARE EDUCATION
SPENDING SAVING
SKILLS OPEN MARKETS
POVERTY MOBILITY

THE OPPORTUNITY RECORD

CED believes that broad economic opportunity is largely consistent with, and can be complementary to, strong and sustained economic growth. This is not to say, however, that unfettered markets with no public intervention will automatically ensure equal economic opportunities.

While we believe strongly that public policies should be directed at opportunities rather than outcomes, we recognize that in practice outcomes greatly affect opportunities, especially when viewed across generations.³¹ After taking into account other factors such as education, labor market conditions, and welfare benefits, parents' incomes remain a powerful predictor of children's incomes later in life.³² Observing the "opportunity record," then, requires an examination of both how individuals and families have fared in the past (outcomes) *and* how they, and particularly their children, are positioned to advance economically in the future (access to and sources of opportunity).

FAMILY INCOMES

The post-war period up to the early 1970s saw a rising economic tide that indeed lifted all boats. From 1966 to 1973,[†] American families in all income quintiles experienced income growth at a robust rate of 2 to 3 percent annually, creating the "picket fence" effect shown on the left side in Figure 10. By the late 1960s, a trend of strong income growth at the

bottom as well as the top of the income distribution led many observers to predict that poverty, as officially measured, would be eliminated by 1980.³³

In the last two decades, however, the economic experience of families at different income levels has diverged sharply, creating the "staircase" effect shown on the right side in Figure 10. Between 1973 and 1994, while families in upper-income categories continued to experience income growth, albeit at half the previous rate, those at the lower end saw their real incomes decline.^{††*}

The data in Figure 10, which use a cash definition of income, do not reflect income from capital gains, fringe benefits such as employer-paid health insurance, government-provided non-cash benefits such as food stamps, Medicare, Medicaid, school lunches, and rent subsidies, and the impact of taxes, including the earned income tax credit. They are also not adjusted for changes in family size over time. They do, however, include gov-

[†]Unfortunately, data on the distribution of family income before 1966 comparable with post-1966 data are not available.

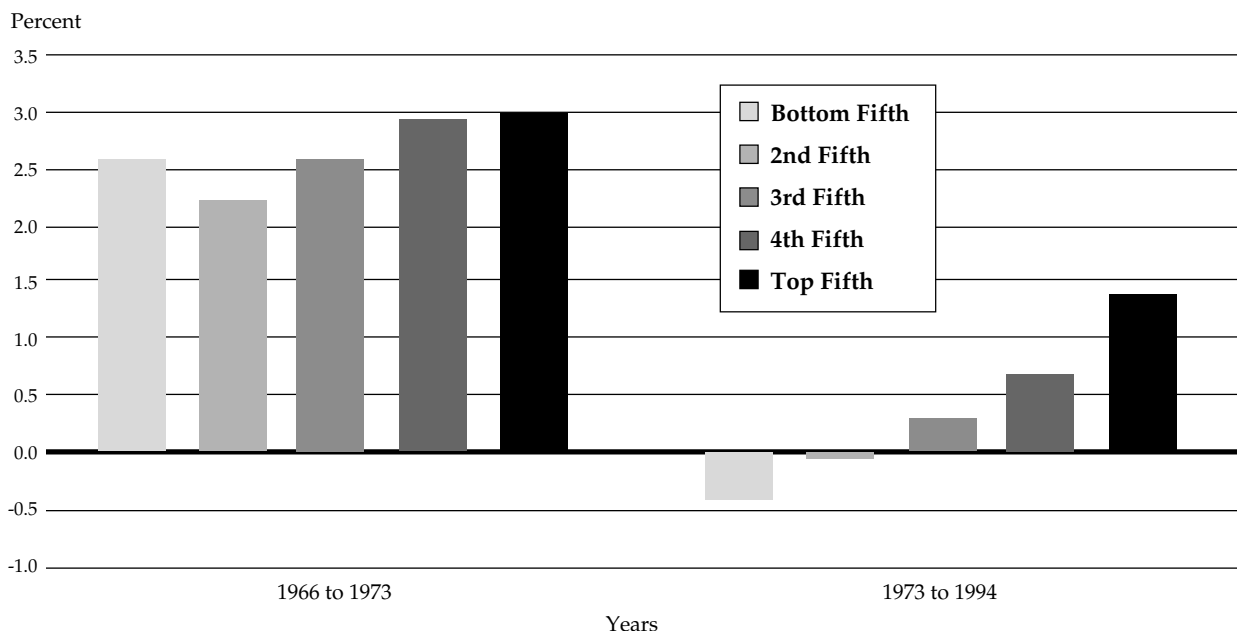
^{††}As noted in the footnote on page 1, while income growth rates would be overstated as a result of overstated inflation measures, there is no reason to expect that a reduction in estimated inflation would reduce the measured larger *dispersion* of income growth rates. Indeed, more accurate inflation measures may actually increase such dispersion, since new goods and services and those most subject to mismeasured quality improvements (e.g. computers, health care, cellular telephones) tend to be more important in high-income than in low-income household budgets.

*See memorandum by JAMES Q. RIORDAN, (page 38).

Figure 10

From Picket Fence to Staircase

Annual Growth of Family Incomes,^(a) 1966 to 1994^(b)



(a) Mean pre-tax family income for each category, in 1994 CPI-U-X1 adjusted dollars.

(b) Annual Averages.

SOURCE: U.S. Department of Commerce, Bureau of the Census.

ernment-provided cash transfers, such as Social Security, unemployment compensation, and public assistance.

Some of these items increase income inequality, while others reduce it. Taken together, the measures of income excluded from the aggregate measure in Figure 10 moderate the depicted inequality slightly. The Census Bureau reports that a comprehensive measure of income “does not change the picture of increasing income inequality over the 1979 to 1994 period,” the period in which inequality grew most sharply.³⁴ This conclusion is supported by an examination of the Gini Index, a commonly used measure of income concentration. It shows that the more comprehensive income measures produce lower overall inequality but do not change the size of the *increase* in inequality since 1979.[†] (There is a 10

percent increase in inequality reflected in the Gini Index for the adjusted and unadjusted measures).

Our concern is not with increasing prosperity for high-income families nor with inequality of incomes per se. Both are expected and, to a degree, useful outcomes in a market-based economy that depends on incentives. We are, however, deeply concerned about the recent decline in incomes at the bottom — especially by the family breakdown, crime, substance abuse, and abysmal educational and

[†] The Gini Index ranges from “zero” (perfect income equality among families) to “one” (one family has all the income). In 1979 the Gini ratio based on the standard “money” definition of income was 0.403, rising to 0.444 in 1995. Using the most comprehensive adjustments (including all of those mentioned above) to the income measure, the Gini ratio would be 0.352 in 1979, rising to 0.388 in 1995.

employment opportunities associated with the rise in poverty. Rather than declining as projected, the poverty rate has actually risen from 12 percent in the early 1970s to 14 percent today. More alarming from a long-term perspective, child poverty has increased from about 15 percent to 21 percent during this same period.³⁵ Measures that adjust income to include non-cash income and benefits also show this long-term upward trend in poverty.³⁶

ECONOMIC AND SOCIAL MOBILITY

This relatively bleak picture of declining and stagnating incomes neglects, of course, the substantial *mobility* of individual Americans between earnings and income groups over time.[†] Such cross-sections or “snapshots” of the income or earnings distribution at different points of time do not capture changes for *specific* individuals and families, who generally experience income growth as time passes

† This is, however, much more true of *inter-generational* mobility than of mobility of individuals or family units. Access to higher education is a fundamental source of this inter-generational mobility (see page 31).

and may move up or down in the distribution. In addition, such data may compare individuals in very different circumstances. Clearly, if individuals and families at very different levels of income readily switch places over time, longer-term or lifetime incomes will be much less unequal than the annual incomes used to measure “snapshot” inequality.

Historically, the economic progress of specific individuals and families — their rise to higher income levels over time — has been substantial in the United States. However, this progress has been strongly related to the nation’s economic growth and to the normal “life-cycle” increase of incomes as individuals grow older. Changes in income due to mobility per se — the “switching” of economic positions — is much smaller, and by no means as high as sometimes suggested. (See “Income Mobility in a Lake Wobegon Society,” below). The evidence indicates that less than half of those who start out in the bottom quintile of family incomes progress to a higher quintile over a moderate period of time (typically measured over five years).³⁷ In general, earnings mobility reduces short-

INCOME MOBILITY IN A LAKE WOBEGON SOCIETY

One widely reported estimate of mobility^a suggests that fully 95 percent of those who started in the bottom quintile of income in 1975 moved into higher quintiles by 1991 and that 29 percent moved into the top quintile. This dramatic finding would dispel many, if not all, concerns about income inequality if it stood up to scrutiny. Unfortunately, it does not. The study’s methodology confounds income *growth* as a result of the life-cycle — that is, 40-year-olds on average have higher incomes than 24-year-olds — with income *mobility*, or changes in income relative to other individuals. Is an individual highly economically mobile if, at the age of 32, he earns a large multiple of what he earned at the age of 16 as a part-time paper boy? This

study would have us believe so.

The study, in effect, compares a group of individuals 32 years old and older in 1991 — those who had been in the bottom income quintile in 1975 — with a “full age” spectrum of individuals 16 years and older in 1991. Clearly the latter, as a group, will include many more very low-earners than the former. The methodology produces a “Lake Wobegon” effect, which allows a disproportionate number of individuals in the “highly-mobile” group to appear well above average.

(a) W. Michael Cox and Richard Alm, “By Our Own Bootstraps: Economic Opportunity and the Dynamics of Income Distribution,” *Federal Reserve Bank of Dallas Annual Report* 1995, 1996.

term “snapshot” inequality by about one-third after five years.[†]

Whatever the degree of mobility, it would have to be *increasing* to counteract the recent rise in “snapshot” inequality. However, studies of different periods have consistently found that mobility has either declined or remained roughly the same during the last several decades.³⁸ Thus, increasing “snapshot” inequality, absent increases in mobility, implies falling incomes for an increasing proportion of the population.³⁹ It is for these individuals that sources of opportunity appear to be most threatened. Given limited resources, efforts to expand opportunity should be effectively targeted toward them. In order to do so, it is necessary to understand the sources of declining opportunities and incomes and the characteristics of those at the bottom of the income scale.

DECLINING ECONOMIC OPPORTUNITIES FOR THE LESS SKILLED

What has produced the deterioration in the economic prospects of low-income Americans? Two major causes can be identified. First, changes in the economy have reduced the demand for the less-skilled labor of individual family members. Second, the dramatic rise in one-parent families has reduced the earning capacity of the family unit.

Declining labor-market opportunities for low-skill, low-wage workers has been pronounced since the 1970s. As overall employment has grown in recent years, the employment prospects for this group of workers (often high school dropouts) have not. High school dropouts today experience nearly five times the rate of unemployment of college graduates, a rate that has remained stable over the past decade, after worsening substantially during the 1970s.⁴⁰ Even in cases where the public safety net has been greatly reduced, the inability to find or hold a job has been persistent among the least skilled and least educated.^{††}

The problem has racial and geographic dimensions as well, with low-wage, urban minorities often facing very bleak employment prospects.⁴¹ One study of fast-food jobs in Harlem found intense competition for job openings. Although the successful applicants were relatively more educated and skilled and tended to have more job contacts than the unsuccessful applicants, even those who were turned down for these jobs were better educated and had more experience than the typical welfare mother.⁴²

Still harsher economic circumstances confront those with so few marketable skills that they cannot find or do not seek *any* legal employment. The largest population in this group is young, single, black men who have dropped out of school. Their deficiencies in skills, citizenship, and motivation place burdens on society and their innate talents and potential productivity have proved frustratingly hard for society to evoke. The combination of these factors has often nurtured an environment filled with social pathologies which virtually destroy or work against individual initiative for self-improvement.

Both slower overall economic growth and the shift in labor-market demand away from less-educated and less-skilled workers towards those with more skills reduced the earnings of the former. The productivity slowdown substantially reduced the growth of average earnings. Had the 1950-1973 rate of productivity

† This appears to be true in several European countries as well. Earnings mobility overall is estimated to be slightly higher in the United States than in several European countries, but the upward mobility of low-income workers is significantly lower. See “Earnings Inequality, Low-Paid Employment, and Earnings Mobility,” Chapter 3, in *Employment Outlook*, (Paris: Organization for Economic Co-operation and Development, July 1996), Chart 3.6.

†† After Michigan ended its general assistance program in 1991, a large number of former recipients remained unemployed or held jobs for only short periods of time. See Sandra Danziger and Sheldon Danziger, “Will Welfare Recipients Find Work When Welfare Ends?” in *Welfare Reform: An Analysis of the Issues*, ed. Isabel Sawhill, (Washington, D.C.: The Urban Institute Press, 1995), pp. 41-44.

growth continued, average real compensation (wages and benefits) in 1995 would have been about \$30 per hour, rather than \$21. At the same time, structural changes in the economy were further depressing earnings at lower skill levels. New technology and new forms of work organization that demanded more skills and versatility appear to have been the primary factors, while immigration of less-skilled workers, imports from low-wage countries, and the decline of unionism probably played less important roles.⁴³ Whatever the precise causes, a skills premium in job opportunities and earnings has emerged in recent years that rewards educated, skilled workers and left less-educated, low-skilled workers far behind.

Figure 11 summarizes the impact of both the productivity slow-down and these structural changes on young male workers. Average real earnings for young males (age 25-34) declined from \$31,368 per year in 1974 to

\$26,928 in 1994. If workers at all wage levels had shared proportionately in the actual average earnings growth during these years, 1994 wages would instead have been \$39,040 for these men. And if productivity and average earnings growth had continued at pre-1973 rates, their annual wages would have been \$56,654.

THE IMPACT OF FAMILY STRUCTURE ON INCOMES

While these economic changes were occurring, a dramatic and rapid change in the composition of families greatly exacerbated the problem. The shift from married-couple families to one-parent families has increased dramatically over the past 25 years (see Figure 12). The problem is particularly acute among black families, who are disproportionately represented at the bottom of the income distribution; a majority of these families are now

Figure 11
Sources of Declining Earnings^(a) for Young Males

Mean Income of Males (Age 25-34), 1974 and 1994

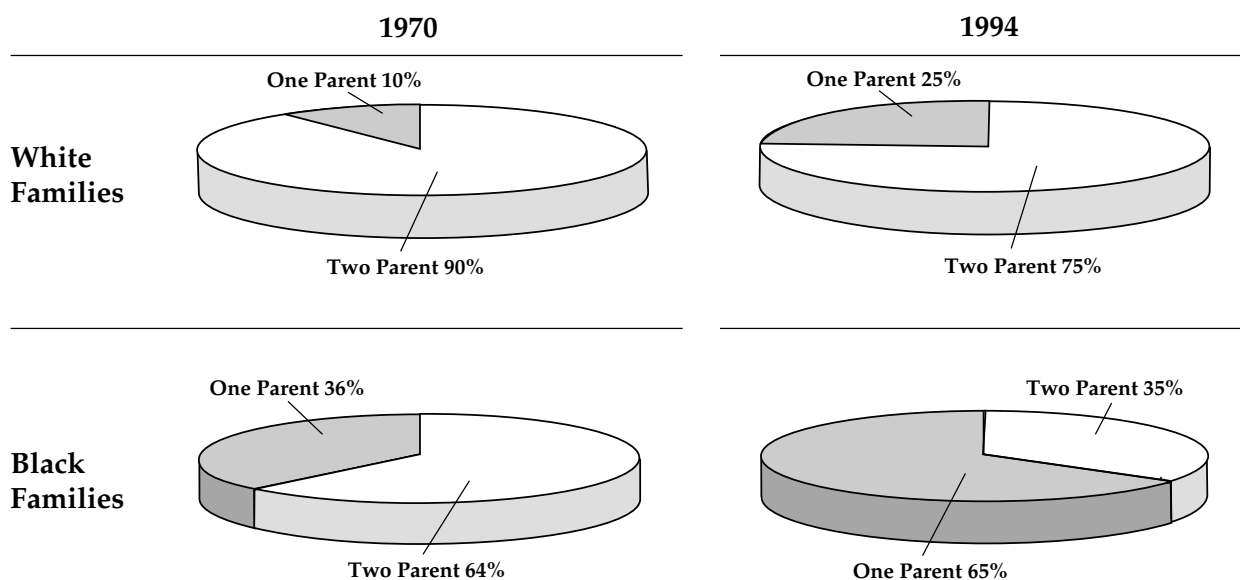


(a) Earnings in 1994 dollars. Faster earnings growth defined as 3.0 percent per year, reflecting actual rate of productivity growth for 1960-1973. Slower earnings growth defined as 1.1 percent per year, reflecting actual productivity growth for 1973-1994.

SOURCE: Daniel McMurrer and Isabel Sawhill, unpublished data, The Urban Institute (Washington, D.C.), 1996.

Figure 12

The Shift to Single-Parent Families^(a)



(a) Family Groups with children under 18 years old.

SOURCE: U.S. Department of Commerce, Bureau of the Census, Current Population Reports, P20-447.

headed by single, most often female, parents. However, the shift has proceeded rapidly throughout our society — the number of non-black, single-parent families rose by 192 percent from 1970 to 1994. The associated sharp rise in out-of-wedlock births resulted principally from a decline in marriage rates, rather than a rise in fertility rates, among all populations.[†]

Children of single-parent families are generally at a disadvantage relative to children of two-parent families in terms of opportunities available to them early in life. For example,

single parents report being less involved in their children's schooling than parents who raise their children together.⁴⁴ The results are evident early in children's school performance: Children of single parents are much more likely to repeat first grade than are children with two parents.⁴⁵

In addition to the negative impact on family life, the trend toward one-parent families has, on average, reduced the earning capacity of low-income families, contributing significantly to rising income inequality. This trend accounts for nearly half of the increase in the incidence of poverty in the population at large since the early 1970s.⁴⁶ More alarmingly, the *entire* increase in child poverty during this period can be attributed statistically to the shift toward one-parent families.⁴⁷ The breakdown of the two-parent family brings with it deep social and economic problems that cannot be fully overcome by public policies.

[†] Birthrates among unmarried women fell significantly for blacks but rose for whites between the late 1960s and the early 1980s, the period of most intense "reproductive technology shock." The marriage rate of women age 15 to 44 fell dramatically for both groups. See George A. Akerlof and Janet L. Yellen, "An Analysis of Out-of-Wedlock Births in the United States," *Quarterly Journal of Economics* (May 1996), pp. 276-317.

RECOMMENDATIONS TO BROADEN OPPORTUNITY

Stagnant or declining real incomes and growing inequality have raised concerns about America's future as the "land of opportunity." How can we ensure that opportunities become or remain open to all? A critical part of the task is to pursue the program for more rapid economic growth outlined above. While a less-dynamic, slowly growing economy may preserve certain low-productivity jobs in the short-term, over the longer term lower growth is likely to diminish opportunities and incomes across society.

But growth, while necessary, may no longer be sufficient. In the past, higher growth alone went a long way toward ensuring opportunity for the vast majority of Americans. While the United States was an agrarian and later an industrial economy, getting ahead typically required little more than what most Americans were willing and able to do — show up and put in an "honest day's work." Such personal attributes are still vitally necessary for productive employment in today's dynamic, globally competitive economy, but they are no longer sufficient to guarantee a middle-class income. Education, skills, and adaptability have become increasingly important, and opportunity beckons for those who possess them. But for those who lack these attributes, more doors will continue to be closed than open.

It is at this juncture that the compatibility — indeed, the synergy — between growth and opportunity become most apparent. In our new, post-industrial economy, the acquisition of human capital is becoming not only the "door to opportunity," but an even more

powerful engine of overall economic growth as well. As a result, the policy recommendations for broadening economic opportunity presented below should also be seen as recommendations to enhance growth by developing the economic capacities of *all* Americans.

What are the pathways of opportunity that take us from birth to adulthood and prepare us for productive working lives? What factors help determine who becomes a skilled, educated worker and who does not? The traditional paths of opportunity can be summarized briefly:

- access to adequate nutrition, health care, cognitive stimulation, and safe neighborhoods *as young children*;
- access to quality schools and other learning environments *as children and adolescents*;
- access to post-secondary education and skill development, based on merit and interests *as young adults*.

Within this framework, we offer recommendations to expand opportunities for individuals from early childhood into adulthood. Efforts to expand opportunity in each of these areas typically involve some public resources. However, where opportunities are lacking, the failure may be due as much or more to an ineffective *use* of public resources as to the amounts provided to address the problems (see "Quality Versus Quantity in Expanding Opportunity," page 25). Often, greater interaction between the public and private sectors through public-private "partnerships" is a useful means of improving program effectiveness, leveraging public resources, and tapping into the expertise and dynamism of the private sector.

RECOMMENDATION 4

OPPORTUNITIES DURING EARLY CHILDHOOD[†]

Poor children often live in environments that produce lifetime setbacks to economic well-being. We support policies that will help improve these environments from birth and, indeed, during the pre-natal period. These include an adequate income safety net for families that is structured to encourage work among the parents and programs outside of the home that prepare children — cognitively, nutritionally, and socially — for the challenges and rewards of K-12 education and beyond.

[†]See the following CED statements: *Why Child Care Matters: Preparing Young Children for a More Productive America* (1993), *Children in Need: Investment Strategies for the Educationally Disadvantaged* (1987), *Rebuilding Inner-City Communities: A New Approach to the Nation's Urban Crisis* (1995).

Poverty, particularly during the crucial first few years of life, greatly reduces the opportunities that children encounter later in life.⁴⁸ Poor children are less likely than non-poor children to develop cognitive abilities at appropriate levels by the time they reach kindergarten.⁴⁹ Cognitive ability is affected significantly by the quality of nutritional and health care afforded children early in life; yet, poor families are more than twice as likely as the non-poor to lack any health insurance, with the lack of coverage particularly acute among the working poor.⁵⁰ Furthermore, poor families are three times as likely as non-poor families to live in neighborhoods where conditions and community services are so bad that they would like to move⁵¹ (see “When Poverty Defines a Place,” page 26).

Children of poor families, particularly of single-parent welfare families, are likely to

QUALITY VERSUS QUANTITY IN EXPANDING OPPORTUNITY

The amount spent on “opportunity programs,” such as those to alleviate poverty or to train workers, may be an important measure of society’s efforts to expand opportunity. But expenditures do not measure *results*. At least as important is the effectiveness with which public resources are used. The experiences of welfare and job training programs are instructive on this point.

There is a broad (and bipartisan) consensus that welfare programs in general have not been effective at broadening opportunity for the disadvantaged. At best, they may do no more than relieve abject poverty.^a Welfare often simply maintains the status quo among poor families, offering them little chance or incentive to break the cycle of poverty. Whether due to a reluctance to force welfare recipients into the labor market or a lack of commitment to provide the resources necessary to end individuals’ need for welfare, welfare programs historically have done little to help recipients help themselves. As a result,

the implicit incentives created by welfare programs often have been inconsistent with the opportunity paths available to the society at large: education, employment, and training.

The experience of public training programs for workers is similarly discouraging.^b Since their inception in the mid-1960s, the federal employment and training programs have been plagued by poor design, poor administration, and frequent policy changes. For example, funding criteria have been too loosely defined, so that expenditures recorded as “training” have often been no more than wage subsidies in public or private low-skill jobs. Such practices have contributed to an overall lack of focus in a proliferation of 164 different training programs. Measured results, not surprisingly, show no effects for youth and only modest success for adults.

(a) See: Irwin Garfinkel, “Economic Security for Children,” in *Social Policies for Children*, ed. Irwin Garfinkel, Jennifer Hochschild, and Sara McLanahan, (Washington, D.C.: The Brookings Institution, 1996), pp. 33-82.

(b) See CED *American Workers and Economic Change* (1996).

WHEN POVERTY DEFINES A PLACE

The lack of opportunity faced by poor children often is made more acute by the communities in which they live. The combination of crime, poor schools, inadequate public services (including police, public transportation, and hospitals), and high unemployment weighs heavily on poor families who reside in inner cities. For inner-city children, the barriers to opportunities for economic betterment are often defined by geography as much as they are by family and other factors. Making inner cities healthy, then, is as much an opportunity strategy for the cities' poor children as it is an economic development strategy for the cities themselves.

Past efforts to address the social and economic problems of inner-city neighborhoods and their residents have often ignored the "social capital" — the community prerequisites — necessary for lasting success. CED believes success requires that both public and private sectors adopt a community-building style of problem solving.^a

This approach has certain distinctive characteristics. Neighborhood residents must participate in efforts to identify and resolve neighborhood problems. Community-based institutions, such as community development corporations, schools, and churches, must become front-line service deliverers within their neighborhoods. In addition, problem-solving efforts must be comprehensive, rather than piecemeal and narrowly focused.

To enhance community building, federal, state, and local governments should encourage and participate in partnerships that link inner-city residents and their community-based organizations to support from government, the business community, and the philanthropic sector.

(a) See the following CED statements: *Rebuilding Inner-City Communities: A New Approach to the Nation's Urban Crisis*, (1995), and *Connecting Inner-City Youth to the World of Work*, (1997).

develop higher cognitive skills in a pre-school environment than they would by remaining at home.⁵² Yet the Head Start program only reaches 17 percent of 3-year-olds and 41 percent of 4-year-olds who are eligible to participate.⁵³ As a result, many poor children enter kindergarten at a learning disadvantage.

It is first and foremost the responsibility of parents to plan their families and invest in their children. In 1990, 45 percent of first births in the United States were to mothers who were teenagers, unwed, or lacked a high school degree. In the environment described by these statistics, public policies cannot substitute for a new ethic of personal and parental responsibility. They can, however, provide some support for children whose parents are unable to do so on their own. Moreover, effective public investments in poor families and children can provide economic returns. They can help to move individuals off welfare and into productive jobs. And they can help turn potential

welfare recipients into productive workers and citizens.

THE EARNED INCOME TAX CREDIT (EITC)

Poor families cannot invest in their children's futures if they are unable to sustain themselves in the present. Individuals who work full-time to support their families should not want for basic needs. **We believe that the EITC represents the best approach to ensuring an adequate minimum income for working families.** The EITC rewards work by providing income supplements for low-wage earners. As the wages of these workers have fallen, the EITC has become an increasingly important source of income for many working poor.[†] Further, under the new work-based

[†] According to the IRS, 18.3 million low-income wage earners claimed \$24.8 billion under the EITC for 1995 (up from \$19.9 billion and 17.7 million filers from the previous year).

welfare system enacted last year (see following section), the EITC is likely to take on an even more important “safety-net” role for unskilled welfare recipients who will be thrust into the world of work at very low wages.

The EITC is also important as a matter of equity and work incentives within the low-income population. For both reasons, it is important that working parents receive larger rewards than those who do not work. The EITC makes it possible to provide other support to non-working mothers while still preserving such a differential.⁵⁴

In response to evidence of program abuse, reforms have been instituted to simplify the filing process, safeguard against fraud, and better target eligibility to intended recipients.⁵⁵ Despite these reforms, the program was targeted by Congress in 1995 for cuts towards its balanced budget goal. This effort failed, although compliance rules were further tightened as part of the overall welfare reform legislation (see “Welfare Reform,” below). **We believe the EITC is a high-priority program and merits continued support. At the same time, policy makers must continue their efforts to improve compliance by reducing fraud, errors, and negligence.**

WELFARE REFORM

The social safety net for low-income families can greatly affect the opportunities available to young children. Therefore, public policies to assist poor families should be designed to foster personal responsibility, motivation for self-improvement, and work, while ensuring that basic needs are met. The EITC is one important element of the safety net. A well-designed welfare system is another. The welfare reforms enacted last year⁵⁶ take a major step away from a decades-old, open-ended income support system to one that limits the time individuals can receive public welfare benefits and requires recipients to work. Through block grants, the new system gives states considerable new flexibility to design

their own welfare-delivery systems. We are concerned, however, about the fact that the federal reforms will substantially reduce federal funds to states in future years while providing weak requirements for states to maintain their own levels of funding for welfare programs.[†]

While the old welfare system often discouraged work, more than a lack of motivation separates many welfare mothers from jobs. For example, 63 percent of those who stay on welfare for five years or more lack a high school diploma. Under anticipated labor market conditions, it is unrealistic to expect that a large proportion of uneducated, inexperienced, low-skill mothers will find and retain employment without substantial interim public support. In a workplace increasingly dependent on skills, education, and the use of technology, the private sector is unlikely to generate enough jobs at non-poverty wages for the approximately two-million welfare recipients, largely unskilled, who will be thrust into the labor market each year (after full implementation of the reforms) as a result of the new work requirements.^{††}

Getting mothers off welfare successfully without endangering their children will require — in addition to motivation on the part of the recipients — education, training, and job placement assistance for the mothers, as well as child and health care for the children. An effective work-based welfare system is likely to cost *more* than the old system, at

† Overall, the legislation is expected to reduce federal spending by \$54 billion over six years. Most of this saving results from reductions in the Food Stamp program and aid to legal immigrants. States are allowed to reduce their own contributions by amounts that total up to \$40 billion over the same period.

†† The Urban Institute estimates that at least 33 percent of those dismissed from the welfare rolls after the five-year limit will be unable to find or hold jobs (this figure is somewhat below the 40 percent estimate made by the Department of Health and Human Services). See Sheila Zedlewski, Sandra Clark, Eric Meier, and Keith Watson, *Potential Effects of Congressional Welfare Reform Legislation on Family Incomes* (Washington, D.C.: The Urban Institute, July 26, 1996).

least in the short term. The public is understandably reluctant to support adults who they believe lack appropriate work incentives and standards of behavior. Nevertheless, the significant long-term costs of failing to protect and help children in need make it easy to be “penny wise and pound foolish.”

Absent a federal “safety-net” of minimum standards and support, poor and needy children and adults in some states will be at particularly high risk, as their states may simply not be up to the task administratively, financially, and politically.[†] States that make an honest attempt to move their welfare clients into productive employment may find the resources for their efforts lacking.^{††} As a result, there is some danger that this bold effort to transform our nation’s welfare system into an opportunity program will fail for lack of financial resources.

CHILD DEVELOPMENT

The likelihood that a child born in poverty will become a poor adult is influenced greatly by developments during the first three to five years of life.⁵⁷ That so much opportunity can be opened or closed off in so short a time is as unsettling as it is promising. We believe it is essential to help poor parents invest in their children’s futures at this early stage. **CED believes that high-quality pre-natal care, child care, and child development programs (such as Head Start) are important public investments that can help break the cycle of poverty.**

Head Start children enter school better prepared than they would have been without this pre-school experience. However, we are concerned that the gains made through Head Start may not be long-lasting, particularly among black children.⁵⁸ The evidence suggests that, in some cases, the investments made at the pre-school level have not been adequately sustained by investments during the school-age years. The implication is clear: **The schools that Head Start children attend must improve**

in order to build on the progress made during the children’s pre-school years.

In addition to the cognitive, nutritional, and social development that programs like Head Start provide, young children need access to health care. Despite our concerns about the impact of the time limits imposed by welfare reform on the well-being of poor children, we note and support the preservation of Medicaid benefits in the new system.

RECOMMENDATION 5

EDUCATIONAL OPPORTUNITIES FOR CHILDREN AND ADOLESCENTS^{†††}

The nation’s public schools must better prepare our youth for an economy in which skills and knowledge increasingly determine success. To improve performance, we must create clear standards for educational outcomes with more effective accountability and incentive structures to help students, teachers, and school administrators raise achievement. We should also work to obtain adequate funding for less-affluent school districts that can use resources effectively.

The quality of K-12 education differs substantially, on average, between high- and low-income children, due to disparities in both resources and their effective use.⁵⁹ Non-poor children, for example, are more likely to use a

[†]The Urban Institute estimates that the new welfare reform legislation will raise the number of children in poverty by nearly 11 percent (from 9.7 million to 10.8 million).

^{††}Financing will be especially problematic for states that provided very low benefits in the past, since the distribution of federal block-grant funding closely follows the prior pattern, in which federal funds were matched to state funding levels.

^{†††}See the following CED statements: *Putting Learning First: Governing and Managing the Schools for High Achievement* (1994), *Connecting Inner-City Youth to the World of Work* (1997), *American Workers and Economic Change* (1996).

computer in the classroom than poor children. The school environment also differs markedly between poor and non-poor children; poor children are nearly twice as likely to attend schools that require security guards and metal detectors.⁶⁰

The cumulative effect of poor early childhood development, inferior schools, and distressed home life is evidenced in the achievement patterns at the high school level. A recent study by the U.S. Department of Education found that while half of all students from high socioeconomic status (SES) families scored in the highest quartile on high school achievement tests, less than a quarter of students from middle-to-low SES families scored in the highest quartile, and just 6.5 percent of low-SES students were top academic achievers.⁶¹

Although there is considerable controversy about whether student achievement has declined absolutely, there is a broad consensus among employers that many schools no longer prepare students adequately for today's more demanding workplace. The problem is particularly acute in the schools that serve our poorest students. We believe a focus on standards, performance incentives, and more effectively targeted funding will move us in the right direction.[†]

STANDARDS FOR ACADEMIC ACHIEVEMENT

The 1996 National Education Summit between business leaders and the nation's governors helped to focus public attention on one of the most critical education issues — the need to raise academic standards. Employers nationwide require and expect a minimum level of proficiency in core academic subjects and especially in the most basic and necessary

skills of reading, writing, and mathematics. As employers, therefore, we continue to support *national* standards for student achievement.

For now, academic standards continue to be determined state-by-state, if at all. We do, however, see two rays of hope. First, if some states succeed in raising standards, healthy competitive forces may be set in motion between states. Second, if businesses articulate skill standards necessary for employment to the schools, an effort that CED strongly endorses, there will be increased pressure to raise school achievement. There are, however, realistic limits to what business can do; it cannot perform what is fundamentally a public responsibility.⁶²

INCENTIVES FOR ACHIEVEMENT

We are persuaded that the educational performance of many schools can be improved by strengthening and restructuring the incentives for academic achievement of students, teachers, and school administrators.

First and foremost, students need stronger incentives to learn. Many students now see little relationship between school performance and future life prospects. Because school performance plays a very limited role in entry-level hiring decisions, this lack of motivation appears rational and is quite understandable. **Therefore, ties between secondary schools and employers must be strengthened, and schools and employers should work together to make the connection.** Further, our K-12 system is designed primarily to prepare youth for college and serves non-college bound students poorly. In this regard, schools should place the counseling of non-college-bound youth on a par with counseling for college-bound students.

To improve business hiring decisions and raise student incentives for achievement, we urge high schools to link curricula and credentials more closely to employer skill requirements. Employers, in turn, should link their hiring decisions more closely to student per-

[†]We recognize that the blame for failure in our nation's classrooms can hardly be laid fully on our schools. In this regard, see: Laurence Steinberg, B. Bradford Brown, and Sanford Dornbusch, *Beyond the Classroom: Why School Reform Has Failed and What Parents Need to Do*, Simon & Schuster (1996) and Laurence Steinberg, "Failure Outside the Classroom," *The Wall Street Journal*, July 11, 1996.

formance and recommendations from school personnel. To accomplish this, **we should remove legal obstacles to the use of high school diplomas, transcripts, and similar assessment information in hiring.** We also urge a more explicit integration of academic and applied learning through *contextualized learning*,[†] which can enhance academic learning by increasing student motivation.⁶³

We recognize and applaud the dedication of many teachers and school administrators. But it is a simple fact that many do not have a strong stake in improving student achievement. They are often neither accountable for improved achievement nor rewarded for it. Moreover, supervisory rules, contractual restrictions, and excessive tenure protections unnecessarily dampen teacher initiatives.

We believe that reforms and programs already underway in some schools can help other schools that are “just getting by” to excel and enable schools that are failing to succeed. Two such programs are *charter schools* and *public school choice*. These innovations hold promise largely because they introduce elements of competition, flexibility, and accountability conducive to improved incentives without abandoning our public responsibility to educate *all* of America’s children. Experiments are currently under way in more comprehensive school choice (that is, providing vouchers to students that can be used at public and private schools), and we note with interest the preliminary results of evaluations of the effects of voucher programs, especially those directed at disadvantaged youth.⁶⁴ However, the experiences with such programs are too limited, and the evidence too scant, to persuade us to endorse comprehensive school choice at this time. As the numbers and scope of such choice and voucher programs grow, we will be in a better position to assess their potential for improving educational achievement.*

Financial rewards should be related more closely to teacher and administrator compe-

tence and effectiveness. We support teacher incentives such as *merit pay* for outstanding performance and *differential pay* to relieve shortages in academic disciplines and to attract better qualified and motivated teachers to these disciplines.

Finally, as a means of increasing accountability, we believe that *site-based management* should be used more extensively. This provides principals and teachers, in consultation with parents and others in the community, with greater authority to make decisions on instruction, personnel, curricula, and the allocation of school resources. Increasing the authority of the employees closest to the customers has improved the performance of our businesses, and we believe it can also work in our public schools.

FUNDING

The principal problem facing most of our public schools has not been a lack of adequate resources, but, rather, their ineffective allocation and use. Per-pupil spending in public elementary and secondary schools has increased more than 80 percent, after inflation, since 1970 and has more than tripled since 1960,^{††} without significant improvements in performance.⁶⁵ One respected study has concluded, “The nation is spending more and more to achieve results that are no better, and perhaps worse.”⁶⁶

We recognize that some public schools are not adequately funded. However, many school systems, including some that serve primarily poor children, spend relatively large amounts per student, yet show deplorable student performance. Providing additional resources to such schools with little or no consideration

[†]Contextualized learning generally refers to classroom learning situations in which students apply abstract knowledge to problems posed in real-world contexts.

^{††}These numbers are likely understated because state administration expenditures are not included in the primary data after 1980-81.

*See memorandum by JAMES Q. RIORDAN, (page 39).

given to improving their management is a substantial waste of money. We believe public schools should have adequate funding, but we also believe the leaders of our school systems must be held more accountable for financial management, service delivery, and especially for educational results.

States have the primary responsibility for ensuring that communities with small taxing capacities receive adequate resources for their schools. Indeed, state and local governments have traditionally provided well over 90 percent of K-12 public school financing.⁶⁷ As state budgets become increasingly constrained, it will become more difficult politically to meet this funding responsibility. Adequate funding across school districts should continue to be a priority in all states and we urge state political leaders to be mindful of this responsibility.⁶⁸

RECOMMENDATION 6

OPPORTUNITIES FOR YOUNG ADULTS[†]

Public and private policies should facilitate access to post-secondary education and skill-development for all Americans who can take advantage of them. Further, a commitment of resources and targeted effort is needed to provide economic opportunity to the least-skilled and least-educated Americans, for whom higher education or employer-provided training are rarely available options.

New technologies, new competitive forces, and new ways of organizing economic activity are changing the nature and structure of work in America. Economic change, like the earlier restructuring from agriculture to in-

dustry, enhances our economic prospects but often outpaces changes in our institutions that provide economic opportunity.

Our current higher education and training systems serve a large number of Americans extremely well, typically those with either the financial resources or jobs that afford them access to high-quality learning and skill development. Higher education has been a fundamental force providing intergenerational mobility in American society. More than one-third of the children of high school graduates surpass their parents in education by obtaining an advanced degree.⁶⁹ Remarkably, about the same proportion of children of high school dropouts go on to obtain an advanced degree.

It is essential that we preserve the access to higher education and training that makes this mobility possible. As advanced learning and training become increasingly important to economic success, lack of access will present an even greater danger of social and economic stratification in our society. We must ensure that our higher education and training systems are responsive to the needs of today's economy and that they serve all members of society.

POST-SECONDARY EDUCATION

Recent economic change has dramatically increased the importance of post-secondary education to the economic opportunities afforded young adults. In 1979, workers with college degrees earned 35 percent more than those with only high school diplomas. By 1993, they earned 78 percent more.

However, the cost of higher education has increased dramatically since 1980: Between 1980 and 1994, tuition at 4-year public universities, a type of institution heavily attended by low-income students, rose 86 percent in inflation-adjusted dollars.⁷⁰ As real incomes have stagnated or declined for many lower-income families and the cost of college has exploded, financial aid has not risen to fill the gap. The real value of the maximum Pell grant (the

[†]See the following CED statements: *American Workers and Economic Change* (1996), *Connecting Inner-City Youth to the World of Work* (1997).

primary grant program for low-income students) has declined 27 percent over the past 15 years.⁷¹

The decline in real grant dollars has made borrowing for college a necessity for more students, regardless of income. However, after accounting for all forms of aid, the financial burden of higher education continues to be much larger for low-income families than for higher income families. As a share of family income, the cost of attending a 4-year public university is, on average, 3 to 4 times greater for lower income families.⁷² Further, a survey of recent college graduates suggests that the strain of student loan payments is realized sooner and to a greater degree by graduates from low-income families than by their higher-income peers.⁷³ Broad-based proposals that would offer tax credits for college attendance to all students, regardless of income, are inappropriate and misguided in the context of scarce public resources. Non-means-tested tax credits would divert these scarce resources away from those who truly lack the money to attend college while providing a financial windfall to those who would attend college regardless of the credit.

Changes in college admission decisions may also be reducing the access of low-income students to education at leading institutions. “Need-blind” admission — a principle of admission of many colleges and universities that ignores ability to pay in considering applicants for admission — shows signs of deterioration, particularly among the more expensive institutions, as administrators are forced to rely increasingly on tuition as a revenue source.⁷⁴

As a result of these trends, at a time when the marketplace has sharply raised returns for a college education, the differential between college enrollment rates of low income and minority youth and those of higher income white youth has increased.⁷⁵ Although low-income youth in general are enrolling at historically high rates, they remain well behind higher-income youth in college enrollment.⁷⁶

We believe that adequate public resources should be made available to ensure that qualified and motivated students of limited means can pursue higher education. At the same time, just as K-12 schools must be held to a high standard of efficiency in the use of public funds, so must programs to fund higher education and the higher education institutions themselves. Programs such as the Pell grant and guaranteed student loans meet an urgent need and funding policies should ensure that they are not abused by fly-by-night “diploma mills” that exist solely to exploit public funds. In addition, legitimate higher education institutions should more aggressively pursue innovations to increase productivity and reduce escalating costs so that they are better able to serve all prospective students.

TRAINING FOR SKILL DEVELOPMENT

To successfully negotiate the twists and turns of a dynamic economy, workers must engage in continuous learning and skill development. Traditional *job security* is becoming less common in today’s economy, and workers must become more dependent on the *employment security* provided by their skills and adaptability. While our K-12 education system is the primary foundation for skill development, community colleges, employer-based training, and public training programs can also be important sources of skill development.

Community colleges have emerged as an innovative and important source of skill development. Through extensive business input, these schools are able to train students using the latest technology and are able to do so according to employer-certified standards of excellence. The advantage of education and training received at community colleges is reflected in earnings: male community college graduates earn 17 percent more and female graduates earn 28 percent more than male and female high school graduates.⁷⁷

Formal, on-the-job training appears to raise firm productivity significantly (by roughly 15

to 20 percent) with associated gains in worker wages.⁷⁸ However, in our new, more competitive economy, proportionately fewer workers are in large, established firms with strong training traditions. Although on-the-job training is increasing, business as a whole may be underinvesting in training. **Because of the increasing importance of supplier networks, we particularly urge larger firms to assist their smaller suppliers with employee training. CED also recommends that educational and other training institutions expand training assistance to smaller firms (e.g., through private-public consortia).**

Public training programs offer another potential source of skill development. However, although CED supports the goals of federal employment and training policies, we cannot support programs as currently designed and administered. For the most part, these programs are uncoordinated, duplicative, and with a few exceptions, ineffective. In 1995-96, despite a promising start, Congress and the President were unable to reach a compromise on work force development legislation that would reform and consolidate federal job training programs.[†] **Streamlining our public training arrangements should be an item of the highest priority for the 105th Congress.**

CED has made several recommendations with respect to these programs. **Accountability for program results should be strengthened and ineffective programs eliminated. Federal training programs should be consolidated into a single program structure under the oversight of one agency. Training assistance should not be a thinly veiled wage subsidy; it should be restricted to counseling, job search, and formal training. Service delivery should be administered by state and local authorities. Finally, programs should**

link training to real jobs through private employer involvement wherever possible.

For the least skilled and least educated, job-based training is precluded by the inability or failure to get a job.^{††} Nor are these individuals served by the many public training programs targeted at dislocated workers. Locked in a vicious cycle of unemployment (or underemployment), little education, and no skills, these individuals fall quickly into public assistance with little hope for economic progress.

Opportunity for these Americans depends critically on efforts to motivate them and ready them for the workplace. Programs that extend a combination of job-placement assistance, education, and skill-development to the least-skilled and least-educated (often high school dropouts or the products of bad schools) provide some hope for a viable future. History demonstrates that expectations for success in these efforts should be modest. The experience of welfare-to-work programs, in particular, suggest that their greatest success is in creating a first step for their clients: getting them into the work force through work requirements and intensive job-placement assistance. In Riverdale and San Diego, California, public investments in such programs have created positive returns by reducing overall welfare payments over time.⁷⁹

[†] Congressional Democrats and the President insisted on a \$1.3 billion program for dislocated workers and objected to the Republican proposal to repeal the School to Work Opportunities Act.

^{††} CED does not believe that employers have a social responsibility to hire unqualified applicants. However, it is legally and morally incumbent on employers to eradicate the influence of stereotypes and discrimination in hiring practices.

CONCLUSION

PRODUCTIVITY TAXES
DEFICITS INCOME
WELFARE EDUCATION
SPENDING SAVING
SKILLS OPEN MARKETS
POVERTY MOBILITY

Since its founding, the United States has been a land of opportunity. But developments of the past 20 years suggest that the pathways of opportunity have become harder to travel for some. A dichotomy has emerged between the dynamism and flexibility of our overall economy and the limited economic opportunities available to some members of our society. In particular, there is a danger that human capital investments, which historically have increased mobility and opportunity, will begin to widen economic disparities if they are not broadly shared in our increasingly skills-based society.

CED is convinced that appropriate policies can enhance both growth and opportunity. We also believe that policies focused on one of

these objectives to the exclusion of the other will ultimately fail, if not economically, then socially and politically. Good growth policies and good opportunity policies are mutually reinforcing. As a result, the policy agenda we lay out in this statement is greater than the sum of its parts. CED urges policy makers to keep this in mind as they consider these recommendations.

While we (and others) can provide analysis and recommendations, only our elected policy makers can provide the political leadership to reject narrow interests and superficially attractive ideology and implement policies that will both enhance economic growth and foster broader opportunity.

NOTES

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MEMORANDA OF COMMENT, RESERVATION, OR DISSENT

Page 2, JAMES Q. RIORDAN

We rightly call for policies that will not only encourage but also eliminate impediments to economic growth and economic opportunity. I am sure that over any reasonable time frame our growth and opportunity goals will not conflict. The GI Bill proved this.

Page 10, JAMES Q. RIORDAN

We are right to state once again that increased national savings are very much needed. It is clear that we would benefit from less government dissaving. It is not true, however, in my opinion, that “the most certain and effective policy to increase national saving is to eliminate the government dissaving resulting from federal budget deficits.” Elimination of federal deficits is anything but certain and our constant calls for political courage to eliminate the deficits have not yet been effective. The national debt has increased every year we have published a statement calling attention to the dangers of increased debt. (Furthermore if we properly accounted for unfunded federal promises we would better understand that our true debt and deficit problem is greater than that politically acknowledged.) I have come to believe that national saving will significantly increase only if private savings significantly increase. Policies that

rely on enlightened self-interest are more likely to work than appeals for political courage. Desirable as reduced deficits would be, our first priorities should be to educate the private sector on the need to increase savings; revamp unfunded federal promises (e.g. Social Security) that encourage people to save less; and reform the tax laws that treat more harshly those who save than those who consume. Private savings don’t need incentives so much as they need the elimination of double taxation disincentives. Since we tax the income from savings, we should not tax income that is saved.

Page 11, EDMUND B. FITZGERALD

This statement is self serving and does not add to the spirit of the CED policy statement.

Page 18, JAMES Q. RIORDAN

The discussion of income disparity in my view is not helpful or relevant to the statement or its recommendations. The disparity data are yet not fully understood, explained, or explored. For example, the numbers are sensitive to the relative earnings growth of the top sliver of super incomes of certain investment bankers; entertainers; athletes; Chief Executive Officers, etc. Furthermore seeming trends in disparities are sensitive to regional

economic cycles. Disparities appear to go down when the midcontinent (with a relatively low cost of living) booms and to increase when California and New York (with relatively high costs of living) boom.

In my view, the need for policies that foster widespread economic growth and opportunity is pressing without regard to trends in the relative compensation of the top 100,000 stars of Hollywood and Wall Street. I am concerned that the disparity discussion is more likely to provoke class warfare debate than to achieve a consensus on either disparity or on the need to eliminate disincentives to save and the need to invest in training, education, and new and better ways to address the problems of disadvantaged children.

Page 30, JAMES Q. RIORDAN

We need to do everything we can to meet the challenge of children living in poverty with single parents in dangerous neighborhoods with failing schools. I think that there is a reasonable chance that increased choice is one of the steps that will help to correct the failing school problem. I hope that CED will soon come to endorse school choice for disadvantaged children, even if it is not ready to endorse it for all children.

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For more than 50 years, the Committee for Economic Development has been a respected influence on the formation of business and public policy. CED is devoted to these two objectives:

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